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THE EVOLUTION OF THE FOREIGN MILITARY SALES PROGRAM AND ITS IMPACT ON DEFENSE PROCUREMENT POLICIES AND PROCEDURES

By

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B.B.A. 1962, North Texas State University

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A Dissertation submitted to

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of The George Washington University

in partial satisfaction of the requirements

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May 1976

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CHAPTER I

INTRODUCTION

Significance of the Problem Area

Within the past decade, the foreign policy of the United States has undergone a significant transition from a cold-war orientation to a greater reliance on cooperation and interdependence with our friends and allies. A major aspect of this evolution has been reflected in the manner in which arms are transferred to foreign countries by the United States. The policy pronouncement known as the Nixon Doctrine, first made by President Richard M. Nixon in 1969 and subsequently embraced by President Gerald R. Ford, included the following basic principles:[1]

1. Partnership with friendly nations in which the obligations, as well as the benefits, of peace are equitably shared

2. A sufficiency of overall military strength, both U. S. and allied, in relation to that of others

3. A willingness to negotiate differences in order to establish the basis for peaceful settlement of disputes likely to lead to conflict

The implementation of this doctrine, coupled with other

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[1]U. S., President, Report to the Congress, U. S. Foreign Policy for the 1970s: A New Strategy for Peace, February 18, 1970.

economic and political considerations, has witnessed a growing reliance on reimburseable arms transfers and a diminution of grant military aid to our allies. Over the past ten years, seventeen nations have made the transition from grant aid to reimburseable sales. In large measure, these reimburseable arms sales have been accomplished through the mechanism of the foreign military sales (FMS) program, meaning that the U. S. Government assumes a unique middleman role in arranging the transaction between the foreign government and the domestic defense contractor.

The involvement of the Department of Defense in the procurement of articles and services for foreign customers is substantial. For example, U. S. defense appropriations for procurement totaled approximately $17 billion for Fiscal Year 1974.[1] During the same period, FMS orders amounted to over $8 billion. In other words, orders for U. S. defense goods and services placed by foreign countries through government-to-government channels during Fiscal Year 1974 were equal to almost fifty percent of the Department of Defense procurement budget, a ratio far greater than at any time in the past.

The provision of arms through FMS and military assistance channels has both its supporters and its detractors. As the Director of the Defense Security Assistance Agency aptly observes:

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[1]U. S., Department of Defense, Secretary of Defense, Annual Report to the Congress, FY 1976 and FY 197T, February 5, 1975, p. D-1.

> At the root of the current public discussion over what the magnitude of arms sales should be are differences between reasonable men over the direction our foreign policy should take and whether the sale of defense articles and services assists or detracts from our foreign policy objectives.[1]

One example of support for the provision of arms to friendly governments through grant aid and FMS was provided by Secretary of State Henry Kissinger in testimony before the Committee on Foreign Affairs of the House of Representatives:

> Political and economic development can only take place in a more secure world. Our military assistance programs and our foreign military sales credits help build such a world. These programs have been modified to encourage nations to bear the primary burden of their own defense. As a result, countries are meeting more of their defense requirements through their own resources. . . .
>
> We must provide adequate credit levels to our friends and allies as we reduce direct government assistance. The foreign military sales program promotes the self-sufficiency we seek and our partners are pursuing.[2]

On the other hand, opponents have criticized both the existence and management of such programs. Former Senator J. W. Fulbright has described the military aid program as a "relic of the past" which deserves "a fitting burial."[3] Senator William Proxmire adds that the military assistance program

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[1]LTG Howard M. Fish, USAF, Director, Defense Security Assistance Agency, "Military Exports--Today's Perspectives," Remarks before the Aerospace Industries Association meeting, San Diego, California, April 22, 1975, p. 2.

[2]U. S., Congress, House, Committee on Foreign Affairs, Fiscal Year 1975 Foreign Assistance Request, Hearings before the Committee on Foreign Affairs, 93d Cong., 2d sess., 1974, p. 10.

[3]U. S., Congress, Senate, Committee on Foreign Relations, Foreign Military Sales and Assistance Act, Hearings before the Committee on S. 1443, 93d Cong., 1st sess., 1973, p. 3.

"appears to be characterized by unmanagement."[1]

Both the magnitude and conduct of the FMS program are of concern to the Department of Defense (DOD). A recent memorandum from Deputy Defense Secretary William P. Clements, Jr. to the Secretaries of the Military Departments, Directors of the Defense Agencies and others contains the following statements (the full text of the memorandum is in Appendix A):

> I am concerned that all elements of the Department of Defense may not be performing their FMS responsibilities in a sufficiently careful and responsive fashion. I urge each of you to reassess your own personal role and that of your institution in seeing that FMS matters are handled with the care and dispatch that they deserve. You should review current policy and your organization's capacity to implement it.[2]

There is additional evidence of DOD interest in FMS and in the procurement policy and procedural implications thereof. In December 1974, as a result of increasing FMS activity and in response to a growing number of procurement issues being identified, the committee responsible for formulating defense procurement regulations established a standing subcommittee to address matters concerned with FMS. The new subcommittee was initially assigned several cases, some of which had been under consideration by predecessor subcommittees for periods exceeding

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[1]U. S., Congress, Joint Economic Committee, Economic Issues in Military Assistance, Hearings before the Subcommittee on Economy in Government, 92d Cong., 1st sess., 1971, p. 185.

[2]U. S., Department of Defense, Deputy Secretary of Defense, Memorandum for the Secretaries of the Military Departments, Subject: "Foreign Military Sales," March 28, 1975.

one year. The subject areas of the assigned cases included pricing, recovery of nonrecurring costs, options for FMS, small business participation in FMS, financing of FMS contracts and offset purchase arrangements.

Also in late 1974, the Air Force completed an in-house study of the impact of the Security Assistance Program on that department.[1] Six separate panels addressed areas such as security assistance objectives, program implementation, resource planning, procurement policy, training, and management. This effort represents what appears to be the most comprehensive assessment of the impact of the Security Assistance Program undertaken by any of the military departments to date. Several findings of the Air Force study are relevant to this research, and these are discussed in Chapter V.

It is against this background of increasing involvement in FMS and concern for the management of the program that the present research has its origin. Although foreign policy considerations cannot be segregated from the subject area altogether, it is not within the purview of this investigation either to support or condemn the efficacy of the foreign policy underlying particular decisions with respect to the provision or withholding of military assistance or FMS. Instead, an examination of the impact of the evolving FMS program on defense procurement policies and procedures provides the

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[1]U. S., Department of the Air Force, Deputy Chief of Staff/Systems and Logistics, Directorate of Military Assistance and Sales, Security Assistance Impact Study, December 1974.

focal point for the research. Prior to setting forth the specific questions that the research is designed to address, it is necessary to define certain key terms and concepts employed in subsequent discussions.

Definition of Key Terms and Concepts

The most highly aggregated term which is descriptive of the phenomenon under investigation is arms transfers. Such transfers include defense articles and services such as arms, ammunition, implements of war and the components thereof, training, manufacturing licenses, technical assistance and technical data related thereto. Included are government transfers under the Foreign Assistance Act of 1961, as amended, the Foreign Military Sales Act of 1968, as amended, or other statutory authority such as ship loan legislation. Also included are transfers made directly by commercial firms to foreign governments, foreign private firms, and international organizations. In other words, both reimburseable and non-reimburseable transfers and government and commercial transfer channels are involved.[1]

Military export sales, a narrower concept, encompasses all sales of defense articles and services whether made by the Department of Defense or by U. S. industry to a foreign

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[1]This definition and the five that follow it are composites of those contained in U. S., Department of Defense, Military Assistance and Sales Manual, Part 1, pp. 1-12, and U. S., Department of Defense, Department of Defense Policy and Responsibilities Relating to Security Assistance, DOD Directive 5132.3, December 20, 1972, pp. 1-2.

government, a foreign private firm, or an international organization. The two categories of military export sales are foreign military sales and direct commercial sales.

From a technical standpoint, the Security Assistance Program includes activities carried out under the Foreign Assistance Act, the Foreign Military Sales Act, and other statutory authorities. For purposes of this research, the evolution of the Security Assistance Program, which is investigated in Chapter III, also takes into consideration direct commercial sales since such sales are subject to government approval and are becoming a more integral part of U. S. arms transfer policy.[1]

Foreign military sales (FMS) refer to reimburseable sales of defense articles and services to foreign governments and international organizations under the authority of the Foreign Military Sales Act or successor legislation. Included are cash sales from Department of Defense inventories, procurement by DOD for cash sales, credit sales, and DOD guaranties of private financing of credit sales.

The Military Assistance Program (MAP), also known as grant aid, refers to the transfer of defense articles and

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[1]From a budgeting and appropriations standpoint, annual appropriations must be obtained for military assistance grant aid under the Foreign Assistance Act of 1961 and for FMS credits and guaranties under the Foreign Military Sales Act of 1968. FMS cash sales, although authorized by the latter legislation, do not involve annual appropriations since the foreign government provides the necessary funds. However, current appropriations available to the DOD are sometimes used to fund cash purchases subject to reimbursement by the foreign government.

services to foreign governments and international organizations under the authority of the Foreign Assistance Act or successor legislation, for which the United States receives no monetary reimbursement.

Direct commercial sales are sales of defense articles and services made by U. S. industry directly to foreign customers which are not administered by the DOD and which do not involve credit arrangements under the provisions of the Foreign Military Sales Act. Commercial sales of items contained on the U. S. Munitions List are subject to export licensing as prescribed by the Department of State International Traffic in Arms Regulations.

Procurement "includes purchasing, renting, leasing, or otherwise obtaining supplies or services. It also includes all functions that pertain to the obtaining of supplies and services, including description (but not determination) of requirements, selection and solicitation of sources, preparation and award of contracts, and all phases of contract administration."[1]

The Armed Services Procurement Regulation (ASPR) is issued by the Assistant Secretary of Defense (Installations and Logistics) pursuant to the authority contained in Section 2202 of Title 10, U. S. Code. The Regulation represents the implementation of the Armed Services Procurement Act of 1947, and, as such, it has the force and effect of law.

A contracting officer is a person who, by virtue of his

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[1]U. S., Department of Defense, Armed Services Procurement Regulation, 1974 edition, July 1, 1974, para. 1-201.13.

position or by appointment made under the provisions of the ASPR, is authorized to enter into and administer contracts and to make determinations and findings with respect to such contracts. The contracting officer is responsible for performing or having performed all administrative actions necessary for effective contracting.[1]

Policies are statements developed to serve as general guidelines in channeling future actions toward the specified objectives of the organization. A policy does not "set down a series of explicit steps to be followed in performing a task," but it does broadly indicate "the intended course of action."[2] After a policy has been formulated, procedures must be developed to implement the policy by providing in some detail the specific actions to be taken to accomplish a desired task.[3]

Research Questions

The primary research question posed was: How has the foreign military sales program evolved, and what has been the resulting impact on defense procurement policies and procedures as they relate to foreign military sales?

The primary research question suggested further queries. Accordingly, the following subsidiary research questions represented a structured attempt to describe the evolution of

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[1]ASPR 1-201 and 3-801.

[2]Lamar Lee, Jr. and Donald W. Dobler, Purchasing and Materials Management, 2d ed., (New York: McGraw Hill Book Company, 1971), p. 461.

[3]Ibid., p. 479.

the FMS program and to assess the policy and procedural implications thereof:

1. What trends are evident in the various segments of the Security Assistance Program (grant aid, foreign military sales, and direct commercial sales) since their inception?

2. What is the nature of the defense procurement process, what are the critical determinations to be made in effecting foreign military sales, and how do procurements for FMS differ from normal defense procurements?

3. What are the major problems associated with foreign military sales that affect defense procurement policies and procedures?

4. What policy alternatives and procedural revisions within the defense procurement process are proposed as a result of the changing nature of the foreign military sales program?

Scope and Limitations of the Research

Certain limitations were imposed to facilitate inquiry and to delineate the bounds of extrapolation applicable to the research. As alluded to earlier, foreign policy considerations were recognized as being important and sometimes crucial factors with respect to the initiation, negotiation and consummation of foreign military sales; however, such aspects were treated as being external influences on the procurement process. While the existence of a mechanism to insure consistency of FMS with U. S. foreign policy objectives is pertinent to the research, the support or criticism of specific foreign policy decisions was not within the scope of the investigation.

The inquiry was limited to FMS of major weapon systems and equipment, primarily aerospace in nature. As indicated in Chapter III, sales of aircraft and associated equipment account for almost half of the total dollar volume of FMS. This delimitation has the advantage of facilitating data collection and analysis without unduly restricting the investigation to a narrow orientation not amenable to extrapolation or generalization. In other words, the findings and conclusions of the research should be broadly applicable to sales of other categories of equipment, such as vehicles and small arms, since all are procured under essentially the same basic policies and procedures.

The research was further limited to procurement for cash sales in response to foreign government requests. Procedures relating to sales from existing DOD inventories, to supply support arrangements wherein the foreign government "invests" in the U. S. logistics system, and to FMS contracts for training and other services were not specifically examined.

Conceptual Framework and Research Methodology

The basic framework for the research was the conceptualization of the procurement process offered by the Commission on Government Procurement. Chapter IV describes the manner in which the defense procurement process has been adapted over a period of time to accommodate foreign military sales. Significant differences between FMS procurements and normal DOD purchases are identified at each step in the procurement process--

planning, source solicitation, selection and award, and contract administration.

The evolution of the Security Assistance Program examined in Chapter III notes those aspects of the growing importance of the FMS program that might be expected to have an impact on defense procurement policies and procedures. In addition, the federal organization for dealing with FMS is examined, and pertinent criteria by which to judge the performance of the FMS program are identified from appropriate statutes and departmental implementing regulations.

Current problems associated with FMS procurements that affect defense procurement policies and procedures are identified and analyzed in Chapter V. Once again, the conceptualization of the procurement process provides the framework for analysis.

In response to the problem analysis, certain policy and procedural alternatives relative to FMS procurements are introduced in Chapter VI. The alternatives are evaluated against the criteria set forth in Chapter III and in relation to the anticipated impact on the parties involved--the Department of Defense, U. S. industry and foreign governments. According to Robert K. Merton, every applied research, including the examination of policy alternatives, requires some speculative inquiry into the role of diverse factors which cannot be meticulously studied but which can be imprecisely assessed. Consequently, "the recommendations for policy do not flow directly and exclusively from the research. Recommendations are

the product of the research and the estimates of contingent conditions, . . . "[1] As a result of the problem analysis and the evaluation of alternatives, certain recommendations are offered with respect to defense procurement policies and procedures.

Identification of Data Requirements and Sources

The primary sources of data for subsidiary research question one, relating to the evolution of the Security Assistance Program, were as follows: legislation and legislative reports relating to foreign assistance; statistical records and reports of the Departments of State and Defense and selected industry associations; executive orders and government regulations; and books and periodical literature. These sources were supplemented by interviews.

For subsidiary research question two, relating to the defense procurement process and the differences between FMS and normal DOD procurements, data sources consisted of: U. S. Government reports; DOD regulations, instructions and correspondence; legislation relating to foreign assistance; books and periodical literature; and supplementary interviews.

The primary sources of data for subsidiary research question three, relating to current problems associated with FMS procurements, were as follows: interviews with Office of the Secretary of Defense (OSD) staff members, military

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[1]Robert K. Merton, The Sociology of Science: Theoretical and Empirical Investigations, ed. Norman W. Storer (Chicago: University of Chicago Press, 1973), pp. 91-92.

department staff members and representatives of selected procurement activities, and others associated with FMS; DOD internal reports, case files, working papers and correspondence; DOD regulations and instructions; General Accounting Office reports; and legislation relating to foreign assistance.

For subsidiary research question four, relating to policy alternatives and procedural revisions, data sources consisted of: DOD internal reports and correspondence; legislation and legislative proposals; General Accounting Office reports; industry documents; and supplementary interviews with DOD personnel. In addition, the data gathered and analyzed in Chapter V also served as a data source for this question.

Research Techinques Employed

The researcher must decide, from the methodological options available, which techniques are best suited to data collection and analysis in conducting the investigation. While it is true that the nature and circumstances surrounding the research may limit the techniques available, it is also true that the methodology chosen may impose limitations of its own.

According to two authorities, "one of the important criteria is the relative accessibility of the required data to the different means of collection."[1] In planning the data gathering phase of the research relative to the identification of problems associated with FMS procurements and to proposed

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[1]Charles F. Cannell and Robert L. Kahn, "The Collection of Data by Interviewing," in Research Methods in the Behavioral Sciences, eds. Leon Festinger and Daniel Katz (New York: Holt, Rinehart and Winston, 1953), p. 329.

policy alternatives and procedural revisions, it was evident that it would be necessary: (1) to identify those specialists within the particular organizations who possessed the desired information or expertise, and (2) to employ a means of eliciting varied responses in the areas of interest. For these reasons, the interview was selected as the preferred technique which would enable the researcher to identify and select potential respondents. In addition, "one of the principal reasons for the use of interviews rather than questionnaires is to uncover a diversity of relevant responses, whether or not these have been anticipated by the inquirer."[1] Introducing some degree of nondirection to interviewing allows the interviewee to express himself about matters of concern to him rather than those presumed to be important to the interviewer. A semistructured interview is built around a core of structured questions from which the interviewer branches off to explore in depth.[2]

An interview guide was prepared for the purpose of exploring certain areas common to all respondents while allowing new areas to be introduced and explored in depth. A copy of the interview guide is at Appendix B.

Interviewees were selected from three groups--policy-making staff members at the OSD/military department levels

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[1]Robert K. Merton, Marjorie Fiske, and Patricia L. Kendall, The Focused Interview (Glencoe, Illinois: The Free Press, 1956), p. 12.

[2]Stephen Isaac and William B. Michael, Handbook in Research and Evaluation (San Diego, California: Robert R. Knapp, Publisher, 1971), p. 96.

representing the functional areas of procurement policy, security assistance, installations and logistics, research and development, and comptroller; representatives of a selected buying activity within each military department; and representatives of organizations outside of the DOD but associated with FMS such as the Department of State and industry associations.[1]

Where feasible, interviews were taped to facilitate accurate recording of responses. In other cases, notes were made during the interview and were expanded immediately thereafter. In some instances, follow-up contacts were established to expand or clarify points made during the initial interview.

Validity, Reliability and Objectivity

Although the interview technique provides a fruitful approach when data regarding perceptions, attitudes, beliefs, experiences or intentions are being sought, there are some inherent limitations that must be recognized.[2] The adequacy of a data collection technique is normally judged in terms of criteria of validity and reliability. Since interviews are subjective in nature, it is difficult to assure that the criteria are adequately fulfilled.

Validity refers to the extent to which the instrument actually measures what it purports to measure, while reliability relates to the consistency and stability of the measuring instrument. Since it was impractical either to re-interview respondents or to use multiple interviewers to check for

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[1]Appendix C is a list of Individuals Consulted.

[2]Cannell and Kahn, p. 330.

validity and reliability, certain measures were employed to improve the adequacy of the interview technique and to minimize the possible effects of bias:[2]

1. Questions were carefully worded to avoid ambiguity and to match the respondent's frame of reference

2. A conscious effort was made to avoid leading questions or judgments during the course of the interview

3. Questions were employed to establish the respondent's knowledge of the areas of interest to avoid seeking data not available to the interviewee

4. Every interviewee was offered anonymity to encourage candid responses

5. Interviewees were allowed to develop responses fully, and premature conclusion of interviews was avoided

6. In many instances, the observation of documentary records by the researcher facilitated a check on the validity of data obtained during interviews

The investigation was further aided by the researcher's twelve years of experience in the procurement field which assisted in establishing rapport with respondents and in framing questions within familiar terms of reference. The knowledge level displayed by respondents coupled with the precautions employed to reduce bias support the conclusion that acceptable levels of validity and reliability have been attained.

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[1]These measures were adapted from Cannell and Kahn, pp. 343-353, and Isaac and Michael, pp. 96-99.

Anticipated Contributions of the Research

The United States has been involved in providing military assistance to friendly nations in various forms for several decades. Although some aspects of the Security Assistance Program are addressed in the literature, the relationship of foreign military sales to the U. S. defense procurement process has not been addressed in depth and is not widely understood. Accordingly, through synthesizing material drawn from many sources, it is anticipated that this research will contribute to a better understanding of that relationship by:

1. Identifying trends and changes in composition of the various elements of the Security Assistance Program that are relevant to the defense procurement process

2. Examining current problems associated with FMS that affect defense procurement policies and procedures

3. Recommending policy alternatives and procedural revisions within the defense procurement process

Organization of the Report

This chapter provides an introduction to the subject area, defines key terms and concepts, identifies research objectives, delimits the scope of the investigation, describes the methodology employed and the rationale for its use, and suggests anticipated contributions of the research.

The following chapter presents a summarization and evaluation of the existing literature in the field.

Chapter III traces the development of the Security

Assistance Program to include the legislative background, trends in program elements, changes in the complexity of FMS, the future outlook for FMS, the federal organization for security assistance, and criteria or standards of performance for the FMS program.

Chapter IV describes the nature of the defense procurement process, the crucial determinations made in effecting FMS and the differences between FMS procurements and normal DOD purchases.

Chapter V examines current problems associated with FMS that affect defense procurement policies and procedures, following the pattern established in the preceding chapter by identifying the problems associated with each phase of the procurement process--planning, source solicitation, selection and award, and contract administration.

Chapter VI considers certain policy alternatives and procedural revisions proposed as a result of the changing nature of the FMS program.

The final chapter summarizes the report, presents conclusions with respect to the subsidiary and primary research questions, and provides recommendations relative to the uses of the research, including suggestions for further study.

CHAPTER II

PREVIOUS STUDIES OF THE ROLE OF ARMS TRANSFERS

The arms transfer literature in the post-World War II era consists principally of books, dissertations and published and unpublished reports, many of the latter having originated in military service-oriented courses of study. The bulk of the literature has appeared in the last decade. In particular, the outpouring of studies in the past three years can apparently be attributed to increased arms transfer activity and to a concern for the consequences thereof.

Major Studies

The major studies fall into two general categories--those concerned with describing the various arms transfer modes and those which address the arms control aspects of weapon transfers. Books by Harold A. Hovey, Lewis A. Frank and George Thayer are included in the first classification, although the two latter contributions address arms control aspects as well as transfer channels. In the second category are works by the Center for International Studies at the Massachusetts Institute of Technology (MIT), the Stockholm International Peace Research Institute (SIPRI), the U. S. Arms Control and Disarmament Agency (ACDA), and Robert E. Harkavy.

While the latter group of studies is only indirectly

related to this research, a review of such literature is appropriate for several reasons. Much of the available quantitative data on worldwide arms transfers has been drawn together in these works, and such data assist in providing a perspective in evaluating U. S. arms transfer activities. In addition, these books may influence the opinions and actions of the general public, members of the legislative and executive branches of government, and others concerned with arms transfer policies and procedures. Hence, an appreciation of these works contributes to a better understanding of the climate in which arms transfers take place.

In 1965, Harold A. Hovey contributed an historical analysis of the United States Military Assistance Program.[1] This study examined U. S. policies and practices during the 1945-1965 time period. Hovey noted that U. S. policy in the period immediately following World War II was aimed at assisting free world governments to defend themselves against communism. Such assistance took the form of grants of excess military equipment, services and training.

Hovey's analysis of the administration of the Military Assistance Program focused on the search by the Executive Branch for an organizational arrangement to facilitate the coordination of economic and military aid. The Foreign Assistance Act of 1961 established the basic framework whereby military

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[1]Harold A. Hovey, United States Military Assistance: A Study of Policies and Practices, (New York: Frederick A. Praeger, 1965).

assistance is guided by defense policy which, in turn, must be in consonance with general foreign policy objectives.

With regard to foreign military sales, Hovey was writing at the time when the DOD was actively encouraging greater sales of military equipment to foreign nations. According to the study, "the interesting balance of payments problem was undoubtedly the greatest incentive for increases of military export sales, both by private exporters and by the United States Government."[1] He further reported the Department's intent to sell U. S. defense equipment sufficient to account for twenty-five percent of planned expenditures by allied nations through the 1960s.

Following a detailed description and analysis of the Military Assistance Program on both a geographic- and program element-basis, Hovey argued that the foreign aid program should be "abolished." He concluded that military aid should be made a part of the defense budget and be considered in conjunction with other military needs and means of achieving such requirements. The separate consideration of a foreign aid program results in a package "composed of heterogeneous components" which may support neither foreign policy nor defense objectives.[2]

Despite Hovey's recommendations, military aid remains a part of foreign assistance. Although a clearer distinction exists in present legislation between military assistance and economic assistance, both are funded under the foreign aid

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[1]Ibid., p. 183. [2]Ibid., p. 279.

appropriation. Perhaps the policy has been continued on the basis that the Secretary of State retains responsibility for supervision and general direction of the military assistance and foreign military sales programs.

Lewis A. Frank's study of the international arms trade appeared in 1969.[1] The research examined the channels of the arms trade, the factors determining the supply of and demand for arms, and the relation between arms trade and arms control. Frank's analysis focused on quantities of arms transferred and on the motivations of suppliers and recipients.

The Frank study explored the role of the U. S. as a principal arms supplier during the period between the end of World War II and 1968. The study provided a chronology of the shift in emphasis from grant aid to FMS and of the increase in government controls over arms exports. Although Frank's treatment of the U. S. military assistance and sales programs was similar to Hovey's earlier work, Frank also examined the policies of arms-supplying nations other than the United States.

In discussing the prospects for conventional arms control through measures such as increased publicity, end-use controls over weapons, and controls involving the flow of technology, Frank concluded that "the only really effective control over the kind of weapons studied will reside with the principal supplier countries who maintain sufficient power and military strength to encourage the pursuit of more nonmilitary goals by

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[1]Lewis A. Frank, The Arms Trade in International Relations, (New York: Frederick A. Praeger, 1969).

those seeking additional weapons."[1]

In 1969, George Thayer published an emotional account of the arms trade that addressed both government and private transfers.[2] Although he presented only limited quantitative data, Thayer relied primarily on what he described as a close parallel between the incidence of violence and the volume of conventional arms transfers to support the conclusion "that an increase in the availability of weapons is concomitant with an increase in their use."[3]

Thayer's analysis concentrated on arms suppliers--private entrepreneurs, the United States Government, Great Britain, France, and the Soviet Union. In chronological fashion, he recounted the rise and partial decline of private arms merchants and the nationalization of most arms transfer mechanisms, particularly in the United States. The post-World War II era witnessed a tremendous outflow of grant aid followed by an emphasis on arms sales beginning in the early 1960s. The objectives of the re-vitalized sales program established by the DOD included: (1) promoting the defensive strength of allies, (2) promoting cooperative logistics and standardization of equipment among allies, and (3) offsetting unfavorable U. S. balance of payments deficits.

According to Thayer, none of these objectives had been

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[1]Ibid., p. 226.

[2]George Thayer, The War Business: The International Trade in Armaments, (New York: Simon and Schuster, 1969).

[3]Ibid., p. 20.

met by 1969. In the first instance, he cited the problem-ridden sale of F-104 aircraft to Germany, the cancelled Skybolt missile program with Great Britain, and the Middle East and Latin American arms races as evidence of such failure. Regarding cooperative logistics and standardization, Thayer characterized them as DOD ploys to increase sales of U. S. equipment. Finally, he concluded that the use of weapon sales to offset balance of payments deficits was an inappropriate objective.

As a result of his analysis, Thayer concluded that "the shift from the private to the public sector in the past quarter-century has not improved matters."[1] While private merchants have been subject to review by law, the bureaucrats who conduct government arms transfers are immune to scrutiny and control. "The real culprit today has become diffuse, an abstraction, a zephyr that often defies precise identification."[2]

In assessing prospects for international arms control, Thayer predicted that multilateral agreements incorporating regional arms freezes in major trouble areas would stand the best chance of success; however, he was not optimistic concerning the immediate prospects for such agreements. In the interim, he suggested that the U. S. undertake several unilateral measures with respect to arms sale policy such as: (1) discontinuing sales for the purpose of improving balance of payments deficits, (2) raising the decision level for arms

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[1]Ibid., p. 366. [2]Ibid., p. 368.

sales within the Executive Branch and the Congress, (3) restricting eligibility for sales to selected instances in response to specific threats, and (4) abolishing the private trade in arms. In summary, "America's arms policy must be subordinate to its overall, long-term foreign policy objectives; it must be tightly policed and, above all, it must be flexible, reasonable and minimal."[1]

In 1970, the first of several comprehensive studies of arms transfers and arms control appeared.[2] The Center for International Studies at MIT performed the research under the sponsorship of ACDA. The inquiry was aimed at: (1) understanding the process by which conventional arms are transferred to less developed countries, and (2) recommending policies that arms-producing states should pursue in providing arms to such nations. A sample of fifty-two less developed countries was selected using a criterion of per capita gross national product of under $500 per year. Quantitative data for eleven categories of major weapons were amassed for the period 1945-1968. Cost data were eschewed due to their lack of comparability brought about by factors such as imputing values of grants, accounting for exchange rate differences and the effects of deflation or inflation, and allowing for concessionary prices or payment terms. In addition, transfer modes were not

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[1]Ibid., p. 383.

[2]Amelia C. Leiss, et. al., Arms Transfers to Less Developed Countries, (Cambridge, Massachusetts: MIT Center for International Studies, 1970).

differentiated, i.e., grants, sales, and subsidized sales were all treated in the same manner.

While the study noted a leveling off of transfers during the 1965-1968 time frame, a trend toward increased modernization of weapons was also observed, as was an increase in the number of arms-supplying nations.

In addition to the extensive data base compiled, the MIT research contributed some useful typologies in describing supplier and recipient behavior patterns. Supplier markets in different weapon categories were characterized as being monopolies, duopolies, oligopolies or free markets. The recipient's acquisition pattern with respect to a particular type of weapon was classified as either accretion, surge, replacement, decretion or single acquisition. In terms of supplier-recipient relationships, donor styles were described as sole supplier, principal supplier or multiple supplier.

The study also attempted to relate weapons categories to force structures in the less developed countries and to describe the relationship between arms transfers and conflicts among nations. The authors concluded that:

> Our detailed analysis has failed to resolve the ambiguities that surround the relationship between arms and conflict or to find fixed rules that would enable one to say definitively that arms "cause" conflict, or certain arms "cause" conflict, or that there is no relationship. But perhaps this is itself a major lesson to learn.[1]

Nevertheless, since conflict resolution was viewed as a proper objective of military assistance and military sales

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[1]Ibid., p. 360.

policy, the research suggested that : (1) in the long term, regional arrangements offer a promising framework for constructing arms control policies, and (2) in the near term, the major burden of controlling arms transfers will continue to fall upon the individual supplier and the recipient. To this end, the study concluded that the U. S. should, through bargaining on a case-by-case basis, design arms transfers in such a manner as to maximize the efficiency of the recipient's forces to perform those activities deemed to be in the interests of the U. S.

The year following the MIT study saw another major work covering essentially the same terrain published by SIPRI.[1] The SIPRI study explored arms trade in major weapons between the developed and underdeveloped nations, excluding trade within NATO and within the Warsaw Pact. The study is unique in that the transactions were measured in terms of standard prices imputed for the purpose and converted to U. S. dollars at constant 1968 prices. The objectives of the research were: (1) to examine the quantitative and qualitative aspects of the arms trade during the period 1950-1969, (2) to explore the factors governing arms import and export policies, and (3) to assess past and present proposals to regulate the international arms trade.

The main trends highlighted by SIPRI included the marked

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[1]Stockholm International Peace Research Institute, The Arms Trade with the Third World, (Stockholm: Almqvist and Wiksell, 1971).

increase in volume and sophistication of arms transfers during the period, the dominance of the U. S. as the leading supplier, and the importance of the Middle East and Asia as recipients. The study characterized supply patterms as hegemonic (using arms transfers to influence dependent recipients), industrial (supporting domestic defense production by exporting arms to those nations willing to pay), and restrictive (forbidding trade that would involve the supplier in conflict). Demand determinants cited by SIPRI included actual or perceived military requirements, the thrust of nationalism, gaining support of internal armed forces, surpluses of exchange earnings, and influences of the super powers.

With regard to arms transfer modes utilized by the U. S., SIPRI noted that, until 1962, nearly all weapons supplied to third world countries by the U. S. were provided without charge. "After 1962 there was an increased emphasis on the sale of weapons, but the policy governing these sales was not significantly different from that governing the gift of weapons."[1] The doctrine of flexible response, introduced by the Kennedy administration in 1961, stressed threats of an internal nature within developing nations. Accordingly, arms transfers to such free-world orientation areas were increased. Subsidized sales took on added importance since such transactions were subjected to fewer restrictions than were grant aid transfers. More recently, under the Nixon Doctrine which stresses self-reliance,

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[1]Ibid., p. 135.

transfers to forward defense areas (countries bordering on the U.S.S.R. or China) began to rise again.

In commenting on international proposals to restrain the arms trade, SIPRI suggested that direct attempts are unlikely to be fruitful:

> The main difficulty is that proposals specifically to limit trade in arms are in their nature discriminatory between producing and non-producing nations. Wider measures to limit armaments or for disarmament (whether on a regional, weapon-by-weapon, or general basis) would avoid this difficulty.[1]

In 1973, the U. S. Arms Control and Disarmament Agency (ACDA) submitted a report to the Congress as required by the Foreign Relations Authorization Act of 1972.[2] The purpose of the study was to explore the impact of conventional arms transfers on U. S. foreign policy. In addition to providing statistical data on arms transfers in terms of both the value and quantities of weapons shipped, the report addressed the policies of both supplier and recipient states, noting that, "United States arms transfers take place within what is probably the most complex legal and regulatory framework of any major arms supplier."[3]

With regard to the politico-military effects of arms transfers, the ACDA report observed the growing number of arms-

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[1]Ibid., p. vii.

[2]U. S., Arms Control and Disarmament Agency, The International Transfer of Conventional Arms, A Report to the Congress pursuant to Section 302, Foreign Relations Authorization Act of 1972 (P.L. 92-352), September 1973.

[3]Ibid., p. 29.

exporting nations and the increasing flexibility of international relations. It was concluded that these trends make ideological and political considerations less likely to limit a supplier's willingness to provide arms.

On the question of the effect of arms transfers on regional stability, the conclusions of the report were very similar to the findings of the MIT study (which was sponsored by ACDA). Arms transfers were viewed as being neither inherently stabilizing nor destabilizing. The provision of arms may contribute to either military balance or imbalance, but arms are seldom the primary cause of armed conflict. "The underlying sources of conflict are substantive political disputes, involving such matters as territory, ideology, power and race."[1]

In assessing the economic effects of arms exports, ACDA noted positive factors such as cost reductions arising from high-volume production and negative influences such as concessionary credit arrangements. Whether or not arms transfers provide an overall economic benefit to the supplier nation was found to be dependent upon: (1) the extent to which the pricing policy on arms exports covers the average cost of production, and (2) whether economies of scale exist for the export items. In cases when the supplier sells arms at or above the average cost of production and realizes economies of scale in their production, such sales reduce the average cost of arms

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[1]Ibid., p. 60.

for the supplier nation's use as well.

The ACDA report reviewed the various post-World War II proposals that had been made to control international transfers of conventional arms and noted that there was no consensus within the international community as to the desirability of controls. The study concluded that the prospects for multilateral conventional arms control agreements would be enhanced by greater progress in nuclear disarmament and by the resolution of outstanding regional disputes.

The latest in the series of major studies of the ramifications of the international arms trade which have appeared in this decade is one by Robert E. Harkavy.[1] His work consisted of a comparative analysis of the worldwide arms trade of major weapon systems in the diplomatic periods represented by the interwar period (between the world wars) and the post-World War II era. Harkavy identified various aspects of the arms trade as dependent variables including: (1) the structure and behavior of the supplier market, (2) donor-recipient patterns, (3) the distribution of transfer modes, and (4) the reciprocal extent of dependency and autarky exhibited by trading nations. A number of systems characteristics of the diplomatic eras were identified as independent variables: (1) the chain of relationships involving polarity, bloc formation, alliance systems and the gradient of power among the major powers,

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[1]Robert E. Harkavy, The Arms Trade and International Systems, (Cambridge, Massachusetts: Ballinger Publishing Co., 1975).

(2) the degrees and types of ideological conflict among the major powers of an era, (3) the degree of "totality" in the conduct of warfare and diplomacy, (4) the prevailing modes of international economic intercourse, (5) the relative degrees of private and governmental control over arms transfers, (6) the structure of international armaments business, and (7) the rate and nature of technological change in weapons.

Harkavy measured the arms trade in terms of absolute numbers of weapons transferred following the lead of the MIT study. With respect to a comparison of the use of transfer modes in the two diplomatic periods, Harkavy noted a significant increase in military assistance in the post-war period and a paucity of such trade in the interwar years. In the post-war period, he observed opposing trends between the behavior of the U.S.S.R. and the U. S., with Russia moving from a predominance of arms sales to a greater emphasis on grants, while the U. S. has moved in the opposite direction. He also cited significant increases during the post-war period in the use of re-transfer, co-production and co-development modes due primarily to the vastly increased costs of arms production.

In reviewing the various attempts at imposing controls on the conventional international arms trade, Harkavy concluded that unilateral measures, such as most U. S. legislative mandates in the post-war period, have been futile. A failure to recognize the systemic nature of the problem at the international level was cited as the culprit. In the final analysis, "what hope there is would appear to lie in collective agreements

among groups of recipients."[1]

Doctoral Research

Three research endeavors at the doctoral level that have been completed in recent years have focused on selected aspects of FMS. Two have dealt with a category of sales known as co-production, while another study examined FMS in a foreign affairs context. Alexander H. Cornell explored several joint manufacturing programs completed by various consortia of nations belonging to the North Atlantic Treaty Organization.[2] His purpose was to identify and analyze the factors that enabled groups of sovereign nations to collaborate under various organizational arrangements in order to carry out co-production programs. Some of the specific projects investigated were the Atlantic Maritime Patrol Aircraft, the Hawk Antiaircraft Missile, and the F-104G Starfighter. Cornell found that rising costs and technical complexities have made development and production of weapons by individual European nations prohibitively expensive. Although it was noted that joint programs must overcome many obstacles in attempting to fulfill the multiple needs and objectives of the participants, the study identified several benefits accruing from such ventures--cost reductions, quality enhancements, and increased joint technical capabilities.

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[1]Ibid., p. 239.

[2]Alexander H. Cornell, "An Analysis of International Collaboration in the Organization and Management of Weapons Co-Production," (Doctoral dissertation, The American University, Washington, D.C., 1969).

Cornell concluded that the cases investigated do demonstrate that cooperative institutions conducting co-development and co-production programs can be successful.

A more recent evaluation of co-production by Howard I. Lukens focused on the United States helicopter industry.[1] Lukens explored the effects of co-production on macro factors (balance of payments, production and income, the national defense budget, employment and developmental aid), and micro factors (revenue, production, costs, technology, personnel and management), to ascertain whether the economic and security interests of the U. S. and participating domestic firms are enhanced through co-production. On the basis of a methodological approach which considered co-production as a companion program to FMS rather than as an element thereof, it was concluded that co-production does operate to enhance the economic and security interests of the U. S. and participating firms. It was suggested that co-production becomes a more attractive alternative as purchasers confronted with economic difficulties of their own seek means of offsetting the cost of acquiring arms. As a result of his findings, Lukens recommended that: (1) an aggressive program be initiated to make government and industry representatives aware of the potential advantages of co-production projects, (2) government and company policies be modified to give supportive recognition to the co-production

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[1]Howard I. Lukens, "Co-Production Within the United States Helicopter Industry," (Doctoral dissertation, The George Washington University, Washington, D.C., 1975).

option, and (3) a co-production organizational element be established within the Department of Defense security assistance organization.

In 1972, David J. Louscher examined FMS, including direct commercial sales, in a foreign affairs context.[1] He suggested that a foreign military sale can best be viewed as an "undertaking." According to Louscher:

> An undertaking can be considered a coalition or alliance of governmental and business actors with not only complementary but also convergent interests, and sometimes even conflicting interests. Although their motives and actions may differ, all are engaged in the same general activity, i.e., selling arms abroad.[2]

The study provided a framework for classifying objectives of FMS and commercial sales, one set dealing with foreign countries and the international system, and another addressing domestic industries and the U. S. economy. Louscher found that there is some cohesion among the semi-autonomous activities of the governmental and non-governmental actors involved that tends toward a specific result. He concluded that FMS constitutes an aggregation of loosely coordinated activities and goals within the United States rather than a government policy.[3]

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[1]David J. Louscher, "Foreign Military Sales--An Analysis of a Foreign Affairs Undertaking," (Doctoral dissertation, The University of Wisconsin, Madison, Wisconsin, 1972).

[2]Ibid., pp. 7-8.

[3]In considering Louscher's conclusion it must be remembered that direct commercial sales are included in his definition of foreign military sales.

Other Reports and Studies

With respect to reports and studies dealing with the FMS program, the following categories of interest can be differentiated: (1) studies dealing with FMS in a general manner, (2) those treating with the use of FMS as a tool of U. S. foreign policy, and (3) those addressing specific aspects of the FMS program which are related to defense procurement policies and procedures either directly or indirectly. The first category includes studies by Warren C. Heintzelman, LeRoy J. Haugh, Henry C. Newell, Carl G. Davaz, and James R. Stivison. Foreign policy aspects of FMS are examined by Dale R. Tahtinen, Paul C. Kinsinger and Charles E. Cunningham. Works in the third classification include those by Trevor T. Kaine and John L. Wilhite, Juan B. Gerala, Howard W. Zaner, S. Kenric Lessey, John D. Parr, and Sam Piccolo and William E. Pokorny.

Warren C. Heintzelman's 1965 thesis marked one of the first efforts to describe the military sales program apart from a more general military assistance or foreign aid framework.[1] His study addressed the legislation and procedures governing sales, the benefits and disadvantages of export sales, the organizational arrangements within the Department of Defense for handling foreign sales, and areas for improvement of the sales program. Although Heintzelman's work provided valuable insights into the sales program at a crucial time in its

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[1]Warren C. Heintzelman, "The Administration and Operation of the U. S. Military Assistance Sales Program," (Thesis, Industrial College of the Armed Forces, Washington, D.C., 1965).

development, his position was one of advocacy. Observing that "the U. S. has not done all that it could to maximize sales of its military hardware," his recommendations were largely aimed at improving sales techniques and making the conditions of sale more favorable to foreign customers.[1]

The following year brought forth an in-depth examination of the FMS program by LeRoy J. Haugh.[2] Taking a somewhat broader perspective of the subject area, Haugh explored industry involvement in export sales as well as the roles of U. S. Government agencies outside the Department of Defense. In addition, programs complementary to direct sales such as cooperative logistics and co-production arrangements were addressed.

Haugh's work also had an advocacy-flavor as evidenced by the following passage:

> Salesmanship must be accompanied by continued support, recognition of the economic problems of other nations, and a willingness to enter into more quid pro quo arrangements. In this environment, total direct sales may very well increase, but offsetting purchases from other nations will also increase.[3]

In 1972, Henry C. Newell described the organization of the Security Assistance Program within the DOD and the military departments noting those changes that resulted from the passage of the Foreign Military Sales Act of 1968 and the assumption

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[1]Ibid., p. 53.

[2]LeRoy J. Haugh, International Logistics: Foreign Military Sales, National Security Management Monograph (Washington: Industrial College of the Armed Forces, 1967).

[3]Ibid., p. 32.

of office by the Nixon Administration in 1970.[1] Although certain program and organizational consolidations had been made, Newell commented on the continuing variances among the military departments in budgeting, funding, payment, processing and control of FMS cases.

On the basis of his findings, Newell suggested more standardized procedures and more centralized organizational arrangements for dealing with security assistance matters. He also recommended that a single programming and budgeting system for security assistance be adopted by the Department of State and the DOD.

Carl G. Davaz examined trends in FMS resulting from the impact of the Nixon Doctrine in a 1973 report.[2] In attempting to assess the future prospects for FMS, Davaz sensed growing Congressional dissatisfaction with the program. He concluded that FMS benefits and recent trends attest to the future viability of the program. However, the eroding competitive position of the U. S. coupled with foreign and Congressional criticism suggested the need for alteration of the institutional arrangements in order to improve the FMS program.

A recent overview of the FMS program was provided by

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[1]Henry C. Newell, "Management of the Department of Defense International Logistics Program," (Research report, Industrial College of the Armed Forces, Washington, D.C., 1972).

[2]Carl G. Davaz, "International Logistics: The Growth and Future of Foreign Military Sales," (Research report, U. S. Army War College, Carlisle Barracks, Pennsylvania, 1973).

James R. Stivison in 1974.[1] This descriptive study included an examination of the legislative chronology of security assistance, the DOD organizational arrangement for dealing with security assistance, budgeting procedures for grant aid and credit sales, and procedures for establishing cooperative logistics arrangements. Although Stivison provided only limited analysis, he agreed with earlier studies that recommended greater standardization of procedures among the military departments.

A recent development in the literature has been the examination of the use of FMS as a tool of foreign policy in a period characterized by rapidly expanding sales. Understandably, most of these studies have focused on the Middle East. Dale R. Tahtinen examined the military balance among the powers of the Persian Gulf region and the effects of U. S. involvement in the area.[2] He found that the U. S. has employed arms sales to retain access to oil and other raw materials produced in the area. As for the conflict potential in the region, the Executive Branch has opted to pursue a policy of indirect involvement through arms sales, training and industry participation. Although such an approach has precluded direct involvement of U. S. forces thus far and has perhaps reduced the cost of weapons to the U. S., there are disadvantages cited by Tahtinen. To the extent that over-arming the region

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[1]James R. Stivison, "Security Assistance Through Foreign Military Sales," (Master's thesis, Florida Institute of Technology, Ft. Lee, Va., 1974).

[2]Dale R. Tahtinen, Arms in the Persian Gulf (Washington, D.C.: American Enterprise Institute, 1974).

increases the need for oil revenues, a continuation of arms sales at a high level could be counterproductive. In addition, the release of high technology military hardware is viewed with increasing concern. Tahtinen concluded that the U. S. should review its policy of continuing heavy arms sales to better define the limits of involvement and to assist the Persian Gulf states in allaying their fears of one another.

Paul C. Kinsinger examined the cases of Israel, Turkey and the Persian Gulf in order to assess the use of arms transfers as a tool of U. S. foreign policy.[1] With regard to Israel and the Persian Gulf nations, Kinsinger suggested that U. S. policy in both the short and the long term has been essentially reactive and tactical rather than comprehensive and cohesive. In the case of Turkey, the Congress employed an arms embargo and effectively removed the use of the arms transfer option by the Executive Branch. Kinsinger concluded that the Congress had less flexibility in manipulating the arms transfer tool due to the consensus-oriented nature of that body. The study also suggested that, while the Ford administration has dealt with arms transfers in a tactical manner, Congressional critics have offered little in the form of policy alternatives.

Another recent study by Charles E. Cunningham, Jr., examined the feasibility of using FMS as leverage against the

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[1]Paul C. Kinsinger, "Some Problems in the Use of Arms Transfers as a Tool of U. S. Foreign Policy," (Research report, The Johns Hopkins School of Advanced International Studies, Washington, D.C., 1975).

oil policies of the Middle East.[1] In light of the growing U. S. dependence on Arab oil, Cunningham explored U. S. options short of resorting to the use of military force, including: (1) a continuation of FMS under present policy guidance, (2) halting FMS while continuing logistic support for existing weapons, or (3) discontinuing both FMS and weapon system support should circumstances warrant. It was concluded that a U. S. option to embargo future FMS and follow-on logistics support may become increasingly available as Middle East nations become more dependent on U. S. support.

The portion of the literature in the field most directly related to this research consists of several studies that address various procurement-connected aspects of foreign military sales. In 1969, Trevor T. Kaine and John L. Wilhite examined certain FMS policies and procedures from the point of view of the customer country.[2] Subject matters explored included difficulties in determining commercial availability of desired items, a lack of accurate pricing information, slippages and discrepancies in deliveries, and variances in policies and procedures among the military departments. Based on the conclusion that the elimination of causes of customer dissatisfaction

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[1]Charles E. Cunningham, Jr., "Foreign Military Sales as a Political Instrument of United States Foreign Policy: The Middle East," (Research report, Air Command and Staff College, Maxwell AFB, Alabama, 1975).

[2]Trevor T. Kaine and John L. Wilhite, "The Buyer's View of the Management of the United States Foreign Military Sales Program," (Master's thesis, Air Force Institute of Technology, Wright-Patterson AFB, Ohio, 1969).

would be beneficial to both governments, the study offered several recommendations--a guidance document addressing buying in the United States, better pricing estimates for inclusion in the letter of offer and more responsive financial and delivery status monitoring. In addition, it was suggested that the approach used by the Canadian Government be explored for possible adoption by the U. S. Government. The Canadian Commercial Corporation (CCC) was established as a government-owned organization for the purpose of assisting foreign governments in procuring goods and services from Canadian sources. The CCC actually handles the procurement on behalf of the foreign customer, soliciting bids from Canadian firms and establishing contracts for desired items. Kaine and Wilhite offered the opinion that such an approach might be feasible for use by the United States.

A recent study by Juan B. Gerala examined the applicability of U. S. procurement law to FMS and explored a number of problems associated with FMS procurements.[1] Subsequent to reviewing selected procurement regulations and statutes and citing contradictions therein, Gerala concluded that there is no clear answer concerning the applicability of U. S. procurement law to FMS purchases. Some of the specific problem areas identified in the study included: (1) inadequate procedures for obtaining pricing information from contractors,

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[1]Juan B. Gerala, "The Foreign Military Sales Program: Areas of Special Consideration," (Research report, University of Oklahoma, Norman, Oklahoma, 1974).

(2) objections raised to foreign government designations of a single source of supply, and (3) a lack of uniformity in recouping nonrecurring research and development costs on FMS procurements. Gerala offered several recommendations for clarifying procurement policies and procedures relative to the problem areas identified.

Howard W. Zaner investigated arms transfers involving aircraft weapon systems, comparing and contrasting procurement channels for the Military Assistance Program, FMS, direct commercial sales and co-production arrangements.[1] Notwithstanding the Congressional mandate to reduce FMS, Zaner concluded that DOD involvement will continue at a significant level due to the delivery commitments that already extend through the present decade. Some of the procurement problem areas cited in the study include: (1) difficulties in determining the reasonableness and allowability of fees paid to sales agents, (2) discrepancies in procedures for recognizing and applying FMS cost and profit factors, and (3) inadequacies in recouping a portion of the nonrecurring cost of changes to weapon systems that benefit both the U. S. and foreign customers. Certain of the problems identified and recommendations offered became a part of the Air Force Security Assistance Impact Study referred to previously as a result of Zaner's membership in the study group.

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[1]Howard W. Zaner, "Selling Aircraft Weapon Systems Through Foreign Military Sales," (Research paper, Defense Systems Management School, Ft. Belvoir, Virginia, 1974). Permission to cite the study obtained from the author.

The economic benefits of FMS were explored in a study by S. K. Lessey, Jr.[1] Using the aerospace industry as an example, Lessey concluded that export sales resulted in favorable influences on business volume, employment levels, production costs, recoupment of research and development investment, procurement costs to the DOD and the industrial production base. Benefits at the national level are translated into tax revenues and a favorable impact on the international trade balance. Despite the favorable economic aspects of such sales, it was suggested that recoupment of research and development investment has not been adequate in all cases.

Another study by John D. Parr examined the potential for reducing FMS in favor of increased commercial sales in response to the sense of the Congress expressed in the Foreign Assistance Act of 1973.[2] Parr concluded that the potential exists for expanded commercial sales, but that the U. S. Government, industry and foreign customers would all be confronted with serious problems in significantly reducing FMS. The U. S. would lose some degree of control over arms sales, weapon system commonality among allied nations might suffer, cost savings through combined procurement would be adversely affected, and the reluctance of some foreign governments and some domestic

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[1]S. K. Lessey, Jr., "Economics of Military Export Sales," (Research report, Air War College, Maxwell AFB, Alabama, 1975).

[2]John D. Parr, "Foreign Military Sales Versus Direct Commercial Sales: A Defense Management Problem," (Research paper, Air Command and Staff College, Maxwell AFB, Alabama, 1975).

contractors to abandon the FMS channel would be difficult to overcome. As for industry problems identified by Parr, many firms do not have an international marketing capability, the lack of a coordinated U. S. policy on arms exports is cited by some contractors, and others feel that U. S. Government involvement through the FMS channel helps offset international competition that is sometimes subsidized by foreign governments. Finally, it was concluded that foreign customers, particularly less-developed countries, would confront certain difficulties in switching from FMS to direct commercial sales. Some nations do not have the technical or management expertise needed to deal directly with industry representatives in the U. S., some still require credit assistance, the need for U. S. logistics support may dictate the use of the FMS channel, and foreign governments often desire to conduct arms transactions through familiar diplomatic channels rather than in the open market.

The feasibility of providing industrial-fund management for FMS was recently investigated by two Air Force officers.[1] The study focused on whether the utilization of such an approach would: (1) free Air Force manpower resources that are presently engaged in FMS, and (2) allow the Air Force to procure spare parts, ground equipment and other support items in anticipation of sales to foreign governments. The investigators suggested that it would be difficult for an industrially-funded activity

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[1]Sam Piccolo and William E. Pokorny, "Security Assistance Sales: The Viability of Industrially-Funded Management," (Research paper, Air Command and Staff College, Maxwell AFB, Alabama, 1975).

to operate in the present FMS environment. An industrial fund requires a relatively constant flow of income which is susceptible to long-range forecasting so that the fund's comparatively fixed labor-intensive costs can be budgeted and recovered. Such conditions would be difficult to fulfill in periods of fluctuating FMS activity. In addition, it was noted that present directives prohibit industrial funds from carrying finished goods as assets, a factor that would apparently preclude purchasing goods and holding them for sale to foreign customers. Notwithstanding their tentative conclusions, Piccolo and Pokorny recommended that a more critical assessment of the industrial-funding concept applied to FMS be performed.

Summary

The book-length studies concerning arms transfers in the post-World War II period have focused on: (1) describing the arms transfer modes employed and the behavior of suppliers and recipients, and (2) assessing the quantitative and qualitative aspects of arms transfers and the prospects for conventional arms control. Although all of the works cited address arms transfers in an international relations- or foreign affairs-context, the latest study by Harkavy goes beyond the earlier studies by attempting to identify and relate variables describing the systemic nature of the subject area.

Despite the more limited scope of this research, a review of the broader aspects of arms transfers and arms control has

provided valuable insights into the chronological development of the subject matter and into the climate within which arms transfers take place. These works have also provided quantitative data to the general public and to government agencies concerned with formulating arms transfer policies and procedures.

Recent research at the doctoral level has concentrated on co-production and on FMS as a foreign affairs "undertaking." Cornell's work examined co-production programs in order to identify factors that facilitate collaboration, while Lukens focused on co-production within a specific industry. Louscher sought to describe how the actions of semi-autonomous governmental and non-governmental actors tend toward the specific result of selling arms abroad. Each has explored a selected aspect of arms transfers in an effort to add to the knowledge of the broader subject area.

A growing interest in the FMS program has been evidenced by the outpouring of reports and studies in recent years, many of which have originated in military service-oriented courses of study. The categories of reports most relevant to the research being conducted included: (1) studies dealing with FMS in a general context, (2) those examining the use of FMS as a tool of U. S. foreign policy, and (3) those addressing aspects of the FMS program which are directly or indirectly related to defense procurement policies and procedures. Although several of the service-school reports are short papers based largely on secondary research, a review of them provided

unique insights. The students preparing such reports have often had direct experience with the problems, discussions with policy-makers in the area of study, and access to documents not readily available to the general public.

In summary, the literature dealing with arms transfers in the post-World War II period in general, and with the foreign military sales program in particular, has expanded rapidly in recent years. The appearance of numerous studies dealing with selected aspects of the FMS program suggests a growing interest in arms transfer mechanisms and the consequences of their use. The literature review also confirms that the relationship of FMS to the defense procurement process has not been addressed in depth and is not widely understood. An analysis of that relationship commences in the following chapter with an examination of the evolution of the Security Assistance Program.

CHAPTER III

EVOLUTION OF THE SECURITY ASSISTANCE PROGRAM

The objective of this chapter is to examine the evolution of the Security Assistance Program for the purpose of responding to the subsidiary research question: What trends are evident in the various segments of the Security Assistance Program (grant aid, foreign military sales, and direct commercial sales) since their inception?

In tracing the development of the Security Assistance Program, the report explores the legislative background of the program, trends and patterns in the program elements, changes in the complexity of foreign military sales, the future outlook for such sales, the federal organization for security assistance, and criteria or standards of performance for the foreign military sales program.

Legislative Background of Security Assistance

The purpose of this section is to briefly explore the major legislative milestones and certain executive implementing actions which have been significant in changing the emphasis on various modes of transferring arms to other countries. The primary transfer modes of interest in the context of this research include the provision of arms through grant aid, government sales for cash, subsidized government sales, and direct

commercial sales.

Although the transfer of arms by the United States is predominantly a post-World War II phenomenon, the role of the Government in such exports has been a matter of concern almost since the Nation was formed. According to Yorick Blumenfeld,

> As early as 1793, the United States wrestled with the question of whether to restrict its war products to home shores. President Washington said no attempt should be made to obstruct the export of arms to any wars ignited by the French Revolution. Secretary of State Thomas Jefferson advised the British Minister to the United States that year, "Our citizens have always been free to make, vend, and export arms."[1]

That policy remained essentially intact until, in 1898, Congress gave the President authority to impose arms embargoes during the Spanish-American War.

During and immediately subsequent to World War I, assistance in support of our allies was primarily restricted to monetary loans. The arms trade was mainly confined to private channels in the post-war period, and large-scale abuses disclosed during the 1934-36 hearings conducted by the Senate Munitions Investigating Committee led to a series of neutrality acts in the late 1930s aimed at requiring the licensing and registration of arms makers and dealers.

With the Lend Lease Program of 1941, the United States opened wide the doors of military assistance. This legislation authorized the sale, exchange, lease, loan or other disposition of any defense article to any government deemed vital to U. S.

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[1]Yorick Blumenfeld, "International Arms Sales," Congressional Quarterly Editorial Research Reports 2 (September 2, 1970): 657.

defense interests. Deliveries under Lend Lease totaled approximately $49 billion by the end of the second World War. Although the program contemplated reimbursement in kind, it became evident following the war that the recipients were largely unable to make repayment. As a result of that experience, post-war assistance provided under the Truman Doctrine to Greece, Turkey, China and other nations was on a grant aid basis.[1]

The North Atlantic Treaty Organization (NATO) came into being in 1949, and the Mutual Defense Assistance Act of that year authorized grant military aid for countries considered vital to our own security and also permitted sales of equipment to other friendly nations. Grant assistance was continued throughout the 1950s by a sequence of annual mutual security acts.[2] The 1951 and 1954 acts continued the reimburseable sale authority as well. In addition, the 1954 statute established the commercial munitions export control conditions which remain in effect at the present time (1975).

Even though foreign military sales were authorized in 1949, the volume of such sales was negligible until about 1958. In addition to the fact that many nations were still not financially able to purchase equipment in the early 1950s,

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[1]Harold A. Hovey, United States Military Assistance: A Study of Policies and Practices (New York: Frederick A. Praeger, 1965), p. 182.

[2]U. S., Department of the Air Force, Directorate of Military Assistance and Sales, Information and Guidance on Military Assistance Grant Aid and Foreign Military Sales, 12th edition, 1970, pp. 53-4.

pricing procedures in effect during that period required a foreign government to pay current replacement cost for items already in the U. S. inventory. The establishment of more competitive pricing policies coupled with the economic recovery of several European nations began to bolster sales in the late 1950s; however, grant aid was to remain the predominant arms transfer mode into the 1960s.[1] An event that was to have later significance was the establishment in 1958 of a credit sales account with the authorization to use collections to finance further sales.

When the Kennedy Administration took office in 1961, several changes concerning the legislative structure and execution of foreign assistance programs were instituted. The Foreign Assistance Act of 1961 consolidated economic aid, military assistance and sales under a single statute. At almost the same time, Secretary of Defense Robert S. McNamara created the Office of International Logistics Negotiations to actively promote the sale of military equipment abroad. In a memorandum to the Assistant Secretary of Defense (International Security Affairs) in early 1962, McNamara stated, "I should like to encourage sales of military equipment appropriate to the needs of foreign nations in every possible way." Issuing further instructions to the Secretaries of the Military Departments in 1963, the Defense Secretary stressed the objectives

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[1]Hovey, pp. 183-5.

to be met in making sales:[1]

1. Promote the defensive strength of our allies, consistent with our political-economic objectives

2. Promote the concept of cooperative logistics and standardization with our allies

3. Offset the unfavorable balance of payments resulting from essential U. S. military deployment abroad

Under the leadership of Henry J. Kuss of the International Logistics Office, the Pentagon soon pushed foreign military sales to a pre-eminent position over grant aid. Aggressive salesmanship, use of the credit sale revolving fund established in 1958, and a DOD arrangement with the Export-Import Bank that extended credit to countries not identified to the Bank culminated in Congressional outcries for reform in the mid-1960s.[2] A 1967 staff report published by the Senate Foreign Relations Committee cited lack of information, weaknesses in interdepartmental coordination, and a failure to reconcile arms control policies with arms sale programs and called for increased legislative oversight.[3]

The Foreign Military Sales Act of 1968 was passed as a direct result of the Congressional dissatisfaction with the

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[1]Peter Feigl, "ASPR Changes Made to Assist Military Sales," Defense Industry Bulletin, 1 (May 1965), pp. 2, 5.

[2]Robert E. Harkavy, The Arms Trade and International Systems (Cambridge, Massachusetts: Ballinger Publishing Co., 1975), p. 223.

[3]U. S., Congress, Senate, Committee on Foreign Relations, Arms Sales and Foreign Policy, Staff Study, 90th Cong., 1st sess., January 25, 1967, p. 12.

then-existing state of affairs. The revolving credit fund was closed out, Export-Import Bank loans were restricted to developed countries, and more stringent controls and ceilings were placed on foreign military sales. The new statute authorized cash sales from Department of Defense stocks, procurement for cash sales, credit sales, and government guarantees of credit sales, while sales authority was withdrawn from the Foreign Assistance Act. Additional requirements for reports to the Congress were also instituted.[1]

Further changes were made in the conduct of the Security Assistance Program during the Nixon Administration. The enunciation of the Nixon Doctrine under which our allies were called upon to share a larger part of the burden of common defense and the findings of the President's Task Force on International Developments in 1970 resulted in reorganization of security assistance in both the State and Defense Depar ments. Some organizational consolidations were made, such as the establishment of the Defense Security Assistance Agency to administer both grant aid and sales programs, and it was made clear that foreign military sales were to be substituted for grant aid as rapidly as possible in support of the Nixon Doctrine.[2]

A third period of intense Congressional scrutiny of

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[1]The Foreign Military Sales Act of 1968, Chap. 2, 22 U.S.C., secs. 2761-4.

[2]Stanley L. Harrison, "Congress and Foreign Military Sales," Military Review 51 (October 1971), pp. 80-82.

foreign assistance commenced in the early 1970s and continues to the present time. Protracted debates in both Houses precluded the passage of a military assistance authorization bill for Fiscal Year 1973, and a series of continuing resolutions was required to extend the funding of previously authorized programs.[1] In the authorizing legislation for Fiscal Year 1974, Congress advised the Executive Branch to return arms transfers to commercial sales channels and to reduce foreign military sales to the maximum extent.[2] The following year, the Administration was directed to submit each foreign military sale exceeding $25 million to Congress for approval in advance of consummation.[3] At present, approximately eight bills have been introduced in the Ninety-fourth Congress which, among other things, would provide for: (1) A six-month suspension of arms sales to the Middle East, (2) Congressional approval of virtually all foreign military sales, and (3) Congressional sanction of certain commercial arms exports beyond the already-existing requirements.[4]

In retrospect, Congressional intent with regard to arms transfer modes has evolved from a lengthy period characterized

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[1]"The Foreign Aid Controversy in the 92nd Congress," Congressional Digest 52 (March 1973), pp. 74-5.

[2]The Foreign Assistance Act of 1973, sec. 25(1), 87 Stat. 714-729.

[3]The Foreign Assistance Act of 1974, sec. 45(a)(5), 88 Stat. 1795-1820.

[4]Bills introduced in the Ninety-fourth Congress as of June 1 1975 include S. 100, S. 795, S. 854, H.R. 197, H.R. 1550, H.R. 3213, H.R. 5659 and H.R. 5660.

by laissez faire, to the extensive use of grants to assist allies in the post-World War II period, to a preference for foreign military sales over grant aid in the 1960s and early 1970s. At present, government-to-government sales of defense articles and services are being increasingly questioned. Although some would apparently favor the use of commercial channels for arms exports, the potential impact of such a policy has not yet been fully explored.

This report now turns to an examination of certain trends and patterns in the use of various arms transfer modes by the United States.

Trends in the Security Assistance Program

The objective of this section is to examine trends and patterns in the use of various arms transfer modes by the United States. To begin with, worldwide arms exports are compared with arms transfers by the U. S. Next, trends in the volume of grant aid, foreign military sales and commercial sales are explored. Finally, some specific patterns within foreign military sales are examined--procurement contract awards, aerospace exports and leading customers for foreign military sales.

A report issued early in 1975 by the United States Arms Control and Disarmament Agency facilitates an examination of the growth of worldwide and U. S. arms exports over the past decade. The reported arms exports represent, "the international transfer under grant, credit, or commercial sales terms of military equipment usually referred to as conventional,

including weapons of war, parts thereof, ammunition, support equipment, and other commodities, considered primarily military in nature."[1] The data represent actual deliveries and do not include commitments or orders which may result in future transfers. Additionally, the arms exports are depicted in both current and constant 1972 dollars so that the impact of inflation on aggregate arms transfers can be ascertained.

An examination of Table 1 indicates that, in terms of constant 1972 dollars, worldwide arms exports have almost doubled in the past decade from $4.4 billion in 1963 to $8.7 billion in 1973. Over the same period, U. S. arms transfers have nearly tripled from $1.6 billion to $4.7 billion expressed in 1972 constant dollars. Clearly, the value of aggregate arms shipments has been increasing significantly.

The preceding portion of this chapter dealt with the legislative background of various arms transfer modes--grant aid, foreign military sales, and direct commercial sales. It will be recalled that the Mutual Defense Assistance Act of 1949 provided the initial post-World War II legislative framework for general military assistance and foreign military sales. Table 2 depicts the evolution of these programs since FY 1950. In terms of cumulative programs, grant aid has amounted to $37.5 billion for the period FY 1950-1974, while foreign military sales deliveries have totaled $16.2 billion during the

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[1]U. S., Department of State, Arms Control and Disarmament Agency, World Military Expenditures and Arms Trade, 1963-1973, Publication No. 74, (Washington: U. S. Government Printing Office, 1975), p. 11.

TABLE 1

WORLDWIDE AND U.S. ARMS EXPORTS

CY 1963-1973

Current and Constant $
(millions)

	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
Worldwide Arms Exports (Deliveries) Current $	3244	3187	3721	4497	4869	5127	5748	5808	6187	8420	9215
Worldwide Arms Exports (Deliveries) Constant 1972 $	4423	4278	4905	5767	6050	6125	6551	6275	6396	8420	8726
U. S. Arms Exports (Deliveries) Current $	1198	1124	1490	1887	2232	2685	3497	3117	3378	4102	5018
U. S. Arms Exports (Deliveries) Constant 1972 $	1633	1509	1964	2420	2774	3210	3986	3368	3492	4102	4752

Source: U. S., Arms Control and Disarmament Agency, World Military Expenditures and Arms Trade, 1963-1973, Publication No. 74, 1975, pp. 72, 119.

TABLE 2

U.S. ARMS TRANSFERS

Grant Aid, Foreign Military Sales, Commercial Sales

FY 1950-1974

Current $ (millions)

	FY50-64	FY65	FY66	FY67	FY68	FY69	FY70	FY71	FY72	FY73	FY74
Military Assistance, Grant Aid	30,528	951	973	876	597	454	382	762	549	593	789
Military Assistance, Service-Funded	-0-	-0-	617	823	1,242	1,726	1,879	2,320	2,847	3,810	1,013
FMS Deliveries	3,319	704	822	887	1,052	1,228	1,325	1,327	1,186	1,385	2,936
FMS Orders	5,163	1,252	1,548	1,000	805	1,558	922	1,644	3,271	3,856	8,263
Commercial Sales Deliveries	*	156	196	238	257	250	438	397	424	362	502

Source: U. S., Department of Defense, Defense Security Assistance Agency, The Journal, FY 1974, Issue No. 122, pp. 107, 108, 112, 113, 117. (Unclassified)

* Not Available

same time span. Cumulative orders for foreign military sales approached $29.3 billion. On a cumulative basis, grant aid has been the larger program to date. This is particularly true when the category designated "Military Assistance, Service-Funded (MASF)" is included. This program, funded in the Department of Defense budget, was established to provide wartime assistance to South Vietnam, Laos, Thailand, Korea and the Philippines. Although such assistance totaled $16.3 billion through FY 1974, MASF is not technically considered grant aid since it is not provided under foreign assistance legislation.

On an individual program basis, Table 2 reveals that grant aid has been declining while foreign military sales have been increasing. Deliveries under foreign military sales have exceeded the Military Assistance Program every year since FY 1967, while FMS orders have been larger than grant aid outlays since FY 1962. It will also be noted that commercial sales deliveries are relatively small compared to FMS deliveries, perhaps indicating that the Congressionally-mandated emphasis on arms transfers through commercial channels is not yet in evidence.

Having established that foreign military sales have been increasing, it is helpful to assess some of the ramifications of this growing activity in terms of increased procurement by the military departments of the U. S., the major product categories of foreign military sales, and the leading arms customers of the United States.

As one would expect, the increase in orders received from foreign governments is reflected in a rise in the value of contracts awarded by the military departments to fulfill such orders. Table 3 depicts the value of such awards for the past five years. (Each contract included in the total exceeds $10,000.) To further substantiate an increasing workload, the value of contract awards for FMS for the first half of FY 1975 exceeded $1.5 billion.[1] Additional factors related to the impact of FMS on the procurement process are discussed in the following chapter.

In terms of both cumulative orders and deliveries under the foreign military sales program, aircraft have historically accounted for about forty percent of all sales. In FY 1974, approximately forty-five percent of FMS orders and forty-seven percent of FMS deliveries consisted of aircraft and spare parts. The second largest category was "vehicles and weapons" which accounted for twelve percent of the orders and ten percent of the deliveries in FY 1974.[2]

Table 4 indicates the importance of military aircraft exports to the aerospace industry. Although the military export figures include deliveries under foreign military sales, grant aid and commercial sales, the magnitude of aerospace activity is demonstrated. It should also be noted

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[1]U. S., Department of Defense, Office of the Assistant Secretary of Defense (Comptroller), Military Prime Contract Awards, 1st Half, FY 1975, February 1975, p. 8.

[2]U. S., Department of Defense, Defense Security Assistance Agency, The Journal, FY 1974, Issue No. 122, p. 1.

TABLE 3

PRIME CONTRACT AWARDS FOR FOREIGN MILITARY SALES

FY 1970-1974

Current $ (millions)

	FY1970	FY1971	FY1972	FY1973	FY1974
Value of Prime Contract Awards for Foreign Military Sales:					
Army	67	137	153	887	1,090
Navy	342	111	959	218	449
Air Force	245	229	357	742	647
Defense Supply Agency	-0-	-0-	-0-	3	2
TOTAL	654	447	1,469	1,850	2,188

Source: U. S., Department of Defense, Assistant Secretary of Defense (Comptroller), Military Prime Contract Awards, October 1970, September 1971, September 1972, October 1973, October 1974; p. 8.

TABLE 4

EXPORTS OF U.S. AEROSPACE PRODUCTS

CY 1970-1974

Current $ (millions)

	CY1970	CY1971	CY1972	CY1973	CY1974
Military Aerospace Products Exported	889	1,123	841	1,354	1,822
Civil-Use Aerospace Products Exported	2,516	3,080	2,954	3,788	5,279
Total Aerospace Exports	3,405	4,203	3,795	5,142	7,101

Source: Aerospace Industries Association of America, Inc., Aerospace Facts and Figures, June 1975, p. 104.

that exports of civil-use aircraft have increased substantially in recent years.

Finally, the increasing value of foreign military sales has been accompanied by and largely attributed to an emerging group of customers, primarily nations of the Middle East. The huge surplus of oil capital accumulated in the recent past is being used to modernize the armed forces of countries such as Iran and Saudi Arabia. Table 5 reveals that substantial purchases in FY 1974 moved Iran and Saudi Arabia to positions one and five on the list of leading FMS customers for the period FY 1950-1974. Israel is number three on the list primarily as a result of resupply efforts by the U. S. following the Mid-East wars. A substantial portion of the assistance given to Israel has been converted to grant aid.

This section of the report has examined aggregate worldwide and U. S. arms exports; trends in grant aid, foreign military sales, and commercial sales; and patterns of significance within the FMS program. The following section explores changes in the composition and complexity of foreign military sales.

The Changing Complexity of Foreign Military Sales

It has already been demonstrated that a trend from grant aid to foreign military sales is in evidence, and the increasing dollar volume of foreign military sales has been shown. The increasing complexity of FMS should also be highlighted. For example, Iran's purchase of the Navy's F-14

TABLE 5

FOREIGN MILITARY SALES ORDERS

TEN LARGEST CUSTOMERS

FY 1970-1974

Current $ (millions)

FY1970		FY1971		FY1972	
Germany	242	Iran	397	Germany	942
Iran	113	Israel	379	Iran	528
United Kingdom	63	Germany	179	Israel	400
Australia	62	Spain	111	Saudi Arabia	342
Canada	53	Saudi Arabia	96	Greece	182
Israel	45	Taiwan	65	United Kingdom	126
Italy	37	Australia	60	Australia	118
Taiwan	33	United Kingdom	47	Italy	81
Jordan	29	Canada	29	Taiwan	78
Greece	29	Jordan	26	Japan	47

FY1973		FY1974		FY1950-1974 (Cumulative)	
Iran	2,104	Iran	3,794	Iran	7,589
Germany	219	Israel	2,118*	Germany	5,473
Turkey	212	Saudi Arabia	588	Israel	3,676
Taiwan	202	Greece	435	United Kingdom	1,971
Israel	197	Germany	218	Saudi Arabia	1,286
United Kingdom	111	Spain	148	Australia	1,160
Italy	91	Canada	94	Canada	1,126
Canada	91	Taiwan	88	Greece	765
Saudi Arabia	84	Korea	81	Italy	712
Greece	57	Chile	68	Taiwan	572

Source: U. S., Department of Defense, Defense Security Assistance Agency, The Journal, FY1974, Issue No. 122, p. 107. (Unclassified)

* Includes $1.5 billion for which payment was waived.

fighter aircraft and Israel's request for purchase of the Air Force's F-15 fighter demonstrate that foreign governments are desirous of obtaining new weapon systems at an early stage of production.[1,2]

Perhaps even more significant is the evolution of foreign military sales toward purchases involving research and development. Figure 1 portrays the life cycle of a major weapon system. From the time when an operational need is first identified, the program evolves through the following phases: conceptualization, validation, full-scale development, production, deployment, and reutilization/disposition. Over the years, FMS have increasingly moved upward in the cycle. For example, many sales were originally consummated to dispose of systems or pieces of equipment no longer needed. Later, operational systems that were deployed by U. S. forces were also provided to our allies. As mentioned above, purchases in recent years have involved weapon systems in the production phase. At this time it is evident that purchases involving research and development are becoming more common.

Two Air Force foreign military sales cases which contain research and development aspects have recently been reported in a leading trade journal. The Saudi Arabian government

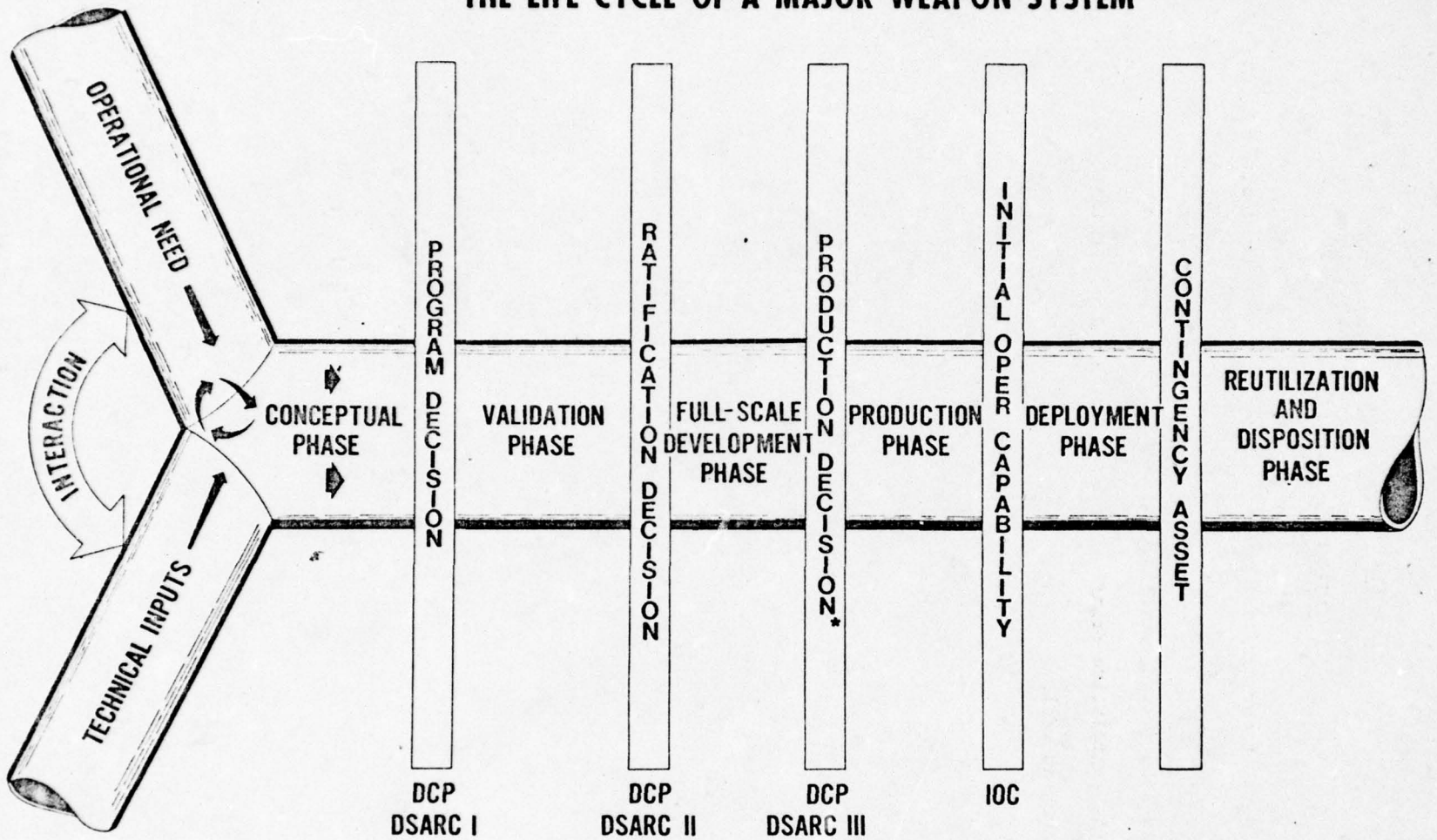
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[1]Michael Getler, "Long-term Impact of Arms Sales to Persian Gulf Questioned," Washington Post, January 30, 1975, p. A14.

[2]The reader is referred to the Glossary of System Designators, Appendix D, for a brief description of each weapon system mentioned.

FIGURE 1

THE LIFE CYCLE OF A MAJOR WEAPON SYSTEM



SOURCE: U.S. General Accounting Office, B-163058, October 23, 1974, p. 2-2.

purchased sixty Northrop F-5 fighter aircraft in January, 1975, for an estimated $750 million. Although the F-5 was developed originally for the Military Assistance Program and has been marketed internationally by Northrop for several years, the F-5 version being sold to Saudi Arabia is not an off-the-shelf system. According to Aviation Week & Space Technology, "the Saudi contract provides funding for development and provisioning of the Arab country's F-5s with advanced air-to-ground standoff weapons, electro-optical acquisition aids and electronic countermeasures that effectively transform the air defense fighter into a potent ground attack system."[1]

The Air Force is also involved in developing a modern air defense network for the Iranian government. In this case, the program involves developing or modifying different long-range radars, defining air defense sectors, acquiring and testing radar tracking systems, and acquiring necessary communications to link the system to air, ground and navy communications.[2]

The Army and Navy are also being pressed to sell newly-developed weapons to foreign governments. Iran is obtaining the Bell AH-1J Sea Cobra helicopter which is equipped to fire the TOW missile.[3] While the Navy is obtaining the McDonnell

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[1]"Decision on Saudi Advanced Weapons Nears," Aviation Week & Space Technology, February 3, 1975, p. 15.

[2]"USAF Pushes Iran Air Defense System," Aviation Week & Space Technology, March 24, 1975, p. 23.

[3]"U. S. Rotary-Wing Aircraft," Aviation Week & Space Technology, March 17, 1975, p. 109.

Douglas Harpoon missile for its own use, "foreign sales to Israel, Iran and other nations have been held up until the missile goes into full-scale production and enters the U. S. inventory."[1]

Although foreign military sales involving research and development are a rather recent phenomenon, the military departments have begun to address the policy and procedural implications of such sales. The Air Force conducted an ad hoc study during the summer of 1974 in an effort to formulate a management system "flexible enough to accommodate the spectrum of FMS cases with special emphasis on new developments or major system integration efforts."[2] The study identified three major areas of difference between the USAF acquisition process and the foreign military sales process. First, the eventual user of the system and its developer are the same in the Air Force process. This is not true in the case of foreign military sales. Second, all Air Force programs compete for limited funds, while foreign military sales are funded by the foreign customer. Third, Air Force programs are evaluated by a thorough requirements review process, whereas the requirements of the foreign government are not subjected to the same degree of scrutiny.

To provide better management of research and development

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[1]"Imminent Navy Decisions Have Long-term Impact," Aviation Week & Space Technology, March 17, 1975, p. 35.

[2]U. S., Department of the Air Force, Deputy Chief of Staff/Research and Development, Systems Acquisition Management for Foreign Military Sales, August 28, 1974, p. 1.

procurements for foreign military sales, the Air Force study recommends that the weapon system acquisition process be applied to such programs on a modified basis. The revised process envisions "a series of Letters of Offer, each one covering only that portion of an acquisition into which the Air Force has reasonable visibility."[1]

Even though the complete study has not yet been officially implemented, one significant change in the Air Force management of research and development programs for foreign military sales has already been put into effect. In late 1974, a Security Assistance Requirements Group was formed under the Deputy Chief of Staff/Research and Development to address those foreign military sales cases which require significant development, systems engineering or systems integration. The new group was created to fill a void that had existed in the management of sales of increasing complexity and dollar value.

The Army has also revised its policies and procedures in recognition of foreign military sales cases which may involve research and development. In March 1975, a Chief of Staff Memorandum entitled, "Management of Foreign Military Sales of Research and Development," was issued. The memorandum establishes "policy and procedures governing Army management of Foreign Military Sales acquisition programs requiring

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[1]Ibid., p. 17.

significant development or systems integration."[1] The document envisions modifying the normal Army weapon system acquisition process to accomodate foreign military sales and also would require sequential letters of offer in a manner similar to that proposed in the Air Force study. Although the procedures addressed in the Army memorandum have not yet been applied to an FMS procurement, the efforts of both the Army and the Air Force tend to confirm the evolution of foreign military sales toward increased research and development procurements and to substantiate a growing concern to address the policy and procedural implications of such transactions.

In the following section, the likelihood of a continuation of a high level of foreign military sales is discussed.

The Future Outlook for Foreign Military Sales

Foreign military sales take place as a result of a blending of complex considerations involving economic, political, cultural, and security factors. Since the ultimate decision to buy rests with a foreign government, predicting future trends in foreign military sales is something of a speculative venture. Nevertheless, there are indications that such sales, particularly to Middle East and NATO countries, will continue at a high level in the foreseeable future.

Lieutenant General Howard M. Fish, Director of the Defense

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[1]U. S., Department of the Army, Deputy Chief of Staff/ Research, Development and Acquisition, "Management of Foreign Military Sales of Research and Development," Chief of Staff Memorandum 75-795-18, March 26, 1975, p. 1.

Security Assistance Agency recently stated that, as of April 17, 1975, foreign military sales for FY 1975 already exceeded $5.8 billion, and he predicted that total orders of between $7 and 8 billion will be accepted. As for subsequent years, Fish observed:

> We believe that sales will continue at the volume experienced in the recent past. There remains today, in the hands of our allies, significant amounts of equipment acquired either under the military grant program or equipment purchased over a decade ago which is now obsolete. In terms of capability to meet the threat, the needed replacement for the F-104 aircraft in several countries is a good example. In addition, many countries formerly in the category of less developed, are now capable of procuring military hardware needed for their own self-defense interests.[1]

As indicated in an earlier section of the report, the Middle East nations of Israel, Saudi Arabia, and Iran have accounted for the bulk of foreign military sales in recent years. In February 1975, a Special Subcommittee on the Middle East of the House Armed Services Committee visited these nations and interviewed top officials, partially for the purpose of assessing military procurement plans of the countries visited.

With respect to Israel, the Subcommittee noted that nation's request for military equipment totaling $1 billion for FY 1976. The report of the Subcommittee also states that "the Israeli long-range preparedness program indicates requests for procurements from the United States approaching $1 billion a

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[1]LTG Howard M. Fish, USAF, Director, Defense Security Assistance Agency, "Military Exports--Today's Perspectives," Remarks before the Aerospace Industries Association meeting, San Diego, California, April 22, 1975, pp. 4-5.

year will be submitted for the next several years."[1]

Regarding Saudi Arabia, the country's huge dollar surplus occasioned by the world's largest oil reserves and the effect of increased oil prices is being used to modernize the armed forces and to improve living conditions. The report adds that, "because of the present state of development and the fact that much of the country is desert, the Saudis are literally unable to spend more than a portion of their income."[2] This year's budget is estimated at $5 billion while a surplus of $20 billion is anticipated.

Prince Fahad Bin Abd Al-Aziz, Saudi Arabia's Minister of the Interior, told the Subcommittee that his country wants to build capable armed forces equipped with weapons as modern as those being obtained by neighboring Arab nations from the Soviet Union or the Eastern Bloc. The Prince emphasized that Saudi Arabia prefers U. S. weapon systems and wants to acquire them expeditiously. The report adds that, "for 1975 it is estimated that foreign military sales orders from Saudi Arabia will total around $1.2 billion."[3] This is double the value of 1974 arms sales. In addition, plans to modernize the Saudi Arabian Navy will involve U. S. purchases extending well into the 1980s.

Iran is likewise using its oil capital surplus to

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[1]U. S., Congress, House, Committee on Armed Services, Report of the Special Subcommittee on the Middle East, H.A.S.C. No. 94-3, 94th Cong., 1st sess., March 11, 1975, p. 8.

[2]Ibid., p. 13. [3]Ibid., p. 14.

modernize its armed forces on an even larger scale than Saudi Arabia. Iran's armed forces and population are five times greater than the Saudi's, and Iran is further along in military and social development. In addition to the quantities of weapon systems already on order, Iran has expressed interest in several systems still under development by the United States. As the leading purchaser of U. S. arms, the Iranians "want to err on the side of enough," and expressed the view that, "What is good for the United States is good for Iran."[1]

Turning to the NATO countries, there is growing concern that increasing weapon systems costs and competing economic demands will operate to force closer cooperation in developing and producing military equipment for the Alliance. Two 1974 reports document several relevant considerations which are likely to result in increased foreign military sales in the United States.[2] For example, a four-nation NATO consortium (Denmark, Norway, Belgium and the Netherlands) recently selected the Air Force's F-16 Air Combat Fighter to replace about 350 F-104 fighter aircraft. There is speculation that the selection by the consortium may ultimately result in the production of

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[1]Ibid., p. 20.

[2]For a detailed discussion of NATO's weapons procurement problems the reader is referred to U. S., General Accounting Office, Benefits and Drawbacks of U. S. Participation in Military Cooperative R&D Programs with Allied Countries, Report no. B-167034, June 4, 1974, and Thomas A. Callaghan, Jr., U. S./European Economic Cooperation in Military and Civil Technology, a report prepared for the Department of State by EX-IM TECH, Arlington, Virginia, August 1974.

2,000 F-16s to be sold for $20 billion.[1]

Having ascertained that there is evidence to support Fish's prediction of a continuing high level of foreign military sales, the report turns to a description of the roles of the Departments of State and Defense in conducting the Security Assistance Program in general and the foreign military sales program in particular.

Federal Organization for Security Assistance

This section briefly describes the roles of the principal agencies of the Executive Branch that are concerned with the operation of the Security Assistance Program with particular emphasis on foreign military sales. The agencies include the Department of State and the Department of Defense.

Within the Department of State, the responsibility for continuous supervision and general direction of economic assistance, military assistance, and military sales programs has been delegated to the Under Secretary for Security Assistance. His functions include determining whether a military assistance program or a sale of defense articles or services shall be initiated with respect to a particular country "to the end that such programs and sales are effectively integrated both at home and abroad and the foreign policy of the United

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[1]David Fouquet, "Belgium Decides on F-16," Washington Post, June 8, 1975, p. A1.

States is best served thereby."[1] The actual preparation of the Military Assistance Program (grant aid) for particular countries and the approval of sales is carried out by the Bureau of Politico-Military Affairs, Division of Security Assistance and Sales.

The extent of Department of State involvement in approving a specific sale is governed by a categorization of countries eligible to receive such sales.[2] Category A nations are authorized to submit requests to purchase defense articles and services directly to the military departments. Category A nations include most of the NATO countries, Australia, Japan and New Zealand. Category B nations must submit requests to purchase to the Department of State and the Department of Defense for approval prior to the initiation of action within the military departments. Most of the Asian, African, and Latin American countries that have been deemed eligible to make purchases are classified as Category B nations. In addition to approving sales to Category B nations, the Bureau must also concur in transfers of previously-furnished defense articles to third countries, co-production agreements, and arrangements which include offset purchasing provisions between the U. S. and other governments.

Another organizational element of the Bureau of Politico-

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[1]U. S., Department of State, "Foreign Assistance Act of 1961 and Certain Related Acts," Delegation of Authority No. 104, November 3, 1961, as amended, Section 6 (b)(1)(B).

[2]U. S., Department of Defense, Defense Security Assistance Agency, Military Assistance and Sales Manual, Part III, Table A-2, pp. A5-7.

Military Affairs that is concerned with the export of military equipment and services is the Office of Munitions Control. Section 414 of the Mutual Security Act of 1954 provides that "the President is authorized to control . . . the export and import of arms, ammunition, and implements of war . . . other than by a United States Government agency."[1] The U. S. Munitions List is defined and export licensing procedures are described in the Department of State International Traffic in Arms Regulations.

Foreign military sales concluded on a government-to-government basis do not normally require the issuance of an export license when the foreign government takes delivery outside the United States; however, an export license must be obtained when (1) delivery is made within the U. S. to a freight forwarder retained by the foreign government, or (2) delivery is made to the foreign government within the U. S.

Direct commercial sales of items contained on the Munitions List must be licensed by the Office of Munitions Control. Prior to granting an export license, the Office solicits a recommendation from the Department of Defense which considers the following factors in arriving at a conclusion regarding the proposed commercial sale:[2]

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[1]The Mutual Security Act of 1954, sec. 414, 22 U.S.C., sec. 1934.

[2]U. S., Department of Defense, Assistant Secretary of Defense (International Security Affairs), Munitions Control Procedures for U. S. Munitions List Export License Applications Referred to the DOD by the Department of State, Directive No. 5030.28, March 10, 1970.

1. Identification of the material and its end use

2. Military advantage or detriment to the U. S. and impact on U. S. Government policy

3. Impact on DOD research and development, production, procurement, and supply for U. S. forces

4. Significance of the proposed export in relation to the state of the art of the technology of the item

5. Copyright, patent, or proprietary rights involved

6. Impact on security assistance programs

7. Conformance with pertinent regulations

8. Implications involving U. S. Government classified information

If the Department of Defense makes a favorable recommendation and the Department of State approves of the sale, an export license is granted.

Within the Department of Defense, the Assistant Secretary (International Security Affairs) is charged with the responsibility for the conduct of the Security Assistance Program including all activities carried out under the Foreign Assistance Act, the Foreign Military Sales Act and related statutory authorities. His functions include but are not limited to coordinating and developing security assistance policy, developing plans and programs, preparing and supporting before the Congress the annual request for legislation and funds, establishing priorities, and representing the Department on security

assistance matters.[1] The Director, Defense Security Assistance Agency (DSAA), has responsibility for directing, administering and supervising approved security assistance plans and programs within the policies established by the Assistant Secretary (International Security Affairs). The Director, DSAA actually has a dual role. He operationally reports directly to the Secretary of Defense in executing security assistance programs and also serves as the Deputy Assistant Secretary (Security Assistance) under the staff supervision of the Assistant Secretary (International Security Affairs). Major functions of DSAA include:[2]

1. Formulation of detailed programs for security assistance

2. Direction and supervision of daily line item management of material and training programs

3. Conduct of international logistics and sales negotiations with foreign countries

4. Liaison with and assistance to U. S. industry regarding military exports

5. Maintaining data required for management of security assistance programs

6. Provision of data and support for annual presentation to the Congress and inclusion in the President's budget

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[1]U. S., Department of Defense, Assistant Secretary of Defense (International Security Affairs), DOD Policy and Responsibilities Relating to Security Assistance, Directive 5132.3, December 20, 1972.

[2]Idem, Defense Security Assistance Agency, Directive 5105.38, August 11, 1971.

Other elements of the Department of Defense are also assigned responsibilities related to security assistance. Although the following organizations do not play a major role in the implementation of foreign military sale procurements, they do play a significant role in the development of the underlying programs. The Joint Chiefs of Staff provide guidance to the Secretary of Defense to insure that security assistance programs support and are in consonance with U. S. military strategic plans and objectives. Commanders of Unified Commands correlate security assistance plans with military plans in specific areas of the world. Military Assistance Advisory Groups located in various countries advise host governments concerning military needs, utilization of grant aid equipment and services, and arranging for purchase of defense articles and services through foreign military sales or commercial sales.

Within each military department there is an organizational element responsible for security assistance programs. Within the Air Force, the Director of Military Assistance and Sales under the Deputy Chief of Staff, Systems and Logistics, is the focal point. The Army's Director of International Logistics under the Deputy Chief of Staff for Logistics has primary security assistance responsibility. Within the Navy, these functions are performed by the Security Assistance Division, Deputy Chief of Naval Operations (Plans and Policies).[1]

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[1]A more detailed discussion of Military Department organization for security assistance can be found in Information and Guidance on Military Assistance Grant Aid and Foreign Military Sales, 12th edition, 1970, published by the Department of the Air Force.

Standards of Performance for the Foreign Military Sales Program

The following excerpts from the Foreign Military Sales Act of 1968, as amended, are relevant to a discussion of the criteria or standards of performance by which the conduct of the foreign military sales program is judged:

> Accordingly, it remains the policy of the United States to facilitate the common defense by entering into international arrangements with friendly countries which further the objective of applying agreed resources of each country to programs and projects of cooperative exchange of data, research, development, production, procurement, and logistics support to achieve specific national defense requirements and objectives of mutual concern. To this end, this Act authorizes sales by the United States Government to friendly countries having sufficient wealth to maintain and equip their own military forces at adequate strength, or to assume progressively larger shares of the costs thereof, without undue burden to their economies, in accordance with the restraints and control measures specified herein and in furtherance of the security objectives of the United States and of the purposes and principles of the United Nations Charter.
>
> It is the sense of the Congress that all such sales be approved only when they are consistent with the foreign policy interests of the United States, . . . with particular regard being given, where appropriate, to proper balance among such sales, grant military assistance, and economic assistance as well as to the impact of such sales on programs of social and economic development and on existing or incipient arms races.
>
> It is further the sense of Congress that sales . . . shall not be approved where they would have the effect of arming military dictators who are denying the growth of fundamental rights or social progress to their own people. . . .
>
> In order to reduce the role of the United States Government in the furnishing of defense articles and defense services to foreign countries and international organizations, and return such transactions to commercial channels, the United States Government shall reduce its sales, credit sales, and guaranties of such articles, and defense

services as soon as, and to the maximum extent, practicable.[1] (Underlining mine.)

Although the preceding portions of the Act summarize Congressional objectives and restraints regarding foreign military sales, other sections of the Act also contain either explicit or implied standards of performance. For example, Section 21 of the Act which authorizes sale of articles from the stocks of the Department of Defense provides that any friendly country or international organization "agrees to pay not less than the value thereof in United States dollars" for such articles.[2] Similarly, Section 22 of the Act authorizes the President to

> . . . enter into contracts for the procurement of defense articles or defense services for sale for United States dollars to any foreign country or international organization if such country or international organization provides the United States Government with a dependable undertaking (1) to pay the full amount of such contract which will assure the United States Government against any loss on the contract, and (2) to make funds available in such amounts and at such times as may be required to meet the payments required by the contract and any damages and costs that may accrue from the cancellation of such contract, in advance of the time such payments, damages, or costs are due.[3] (Underlining mine.)

Section 23 of the Foreign Military Sales Act which authorizes certain credit sales of defense articles and services was amended in 1974 to restrict the granting of concessionary credit terms. The amended language provides for the payment of interest at a rate equivalent to that paid by

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[1]The Foreign Military Sales Act of 1968, sec. 1, 22 U.S.C., sec. 2751.

[2]22 U.S.C., sec. 2761. [3]22 U.S.C., sec. 2762.

the United States Government on marketable obligations of comparable maturity, "unless the President certifies to Congress that the national interest requires a lesser rate of interest and states in the certification the lesser rate so required and the justification therefor."[1]

Collectively, the foregoing provisions of sections 21, 22, and 23 of the Act can be interpreted as a criterion of performance aimed at insuring that foreign military sales are conducted at no monetary loss to the United States Government. Unfortunately, the definition and interpretation of terms such as "value" and "cost" result in standards that are less objective than a cursory examination would suggest. The implications of this criterion are discussed more fully in Chapter V.

Still other provisions of the Foreign Military Sales Act imply performance criteria. Section 42 provides as follows:

> . . . In evaluating any sale proposed to be made pursuant to this Act, there shall be taken into consideration (1) the extent to which the proposed sale damages or infringes upon licensing arrangements whereby United States entities have granted licenses for the manufacture of the defense articles selected by the purchasing country to entities located in friendly foreign countries, which licenses result in financial returns to the United States, (2) the portion of the defense articles so manufactured which is of United States origin, and (3) the extent to which such sale might contribute to an arms race, or increase the possibility of outbreak or escalation of

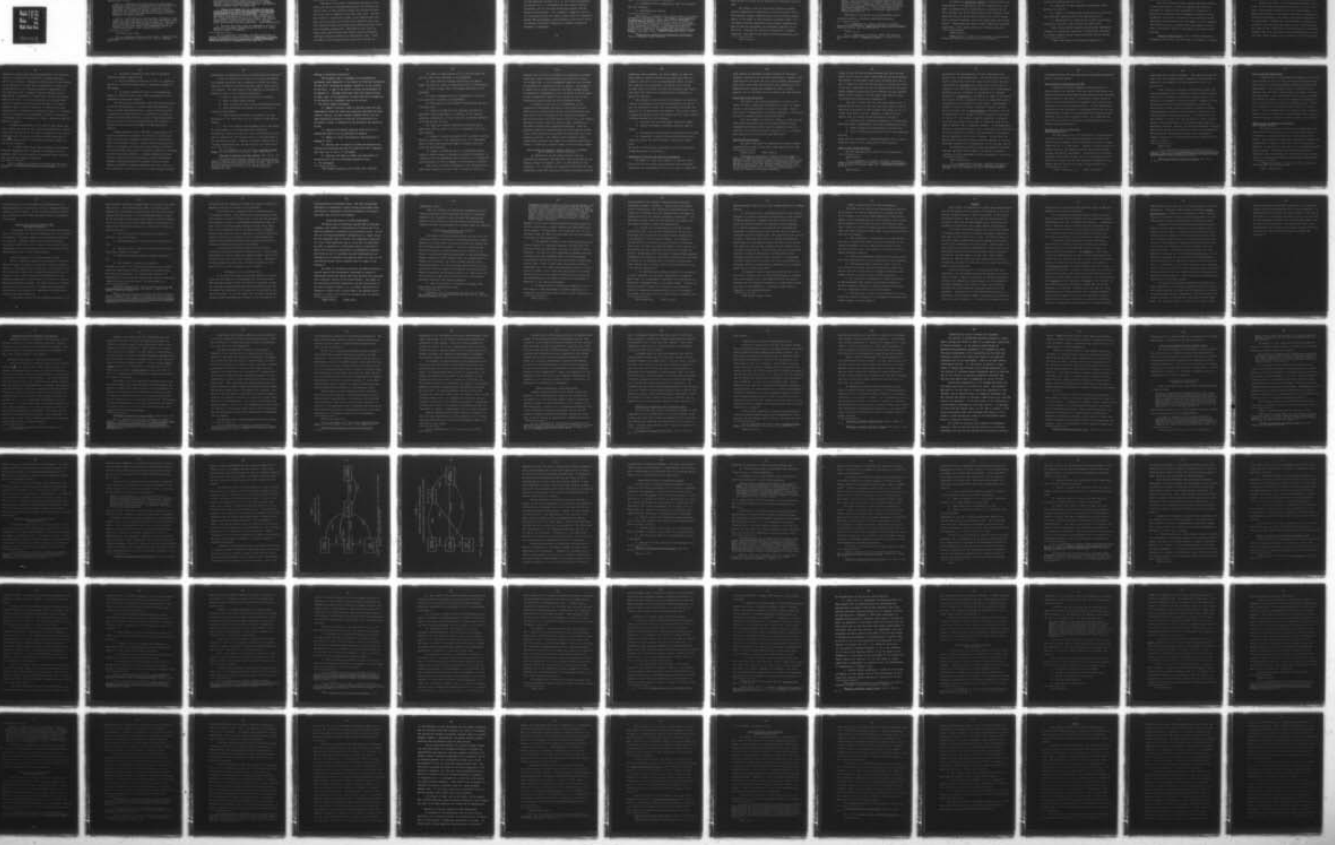
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[1]The Foreign Assistance Act of 1974, sec. 45(a)(2), 88 Stat. 1814.

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THE EVOLUTION OF THE FOREIGN MILITARY SALES PROGRAM AND ITS IMP--ETC(U)
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> conflict, or prejudice the development of bilateral or multi-lateral arms control arrangements.[1]

Although such statements express concern for the prerogatives of U. S. industry and a recognition of the potential danger of arms races, it is difficult to operationally define these criteria in evaluating proposed foreign military sales.

Another potential source of criteria or standards of performance by which to judge the conduct of the foreign military sales program is embodied in the executive orders which delegate the functions conferred upon the President by the various statutes. Executive Order 11501 is the primary document that delegates functions related to the Foreign Military Sales Act. While Section 1 of the Order merely delegates the various numbered provisions of the Act to the Secretaries of Defense and State respectively, Sections 2 and 3 of the Order offer some additional guidance concerning departmental conduct:

> Sec. 2. Nothing in this order shall be construed as modifying in any way the responsibllity conferred upon the Secretary of State by section 2(b) of the Act for the continuous supervision and general direction of sales under the Act, including, but not limited to, determining whether a sale should be negotiated, concluded, or terminated and the amount thereof.
>
> Sec. 3. In carrying out the functions delegated to them under this order, the Secretaries of State and Defense shall consult with the Secretary of the Treasury, the Administrator of the Agency for International Development, and the Director of the Arms Control and Disarmament Agency on matters pertaining to their responsibilities.[2]

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[1] 22 U.S.C., sec. 2791.

[2] U. S., President, Executive Order 11501, "Administration of Foreign Military Sales," December 22, 1969, as amended, secs. 2-3.

Departmental regulations which implement statutory authorities and executive orders provide yet another source of criteria or performance standards by which the conduct of the foreign military sales program can be judged. Department of Defense Directive 5132.3 establishes policy for carrying out the responsibilities of the Department relating to the administration of security assistance under the Foreign Assistance Act of 1968, as amended. Those policy statements which relate most directly to the foreign military sales program are the following:

> A. Security assistance shall be administered in accordance with the (1) provisions of the Foreign Assistance Act, and the Foreign Military Sales Act, and (2) subject to the limitations of the foreign policy and national security objectives of the U. S. It shall support and be in consonance with U. S. military strategic plans and objectives and be guided by the policy and planning guidance issued by the Secretary of Defense, and by guidance issued by the Secretary of State.
>
> H. To the extent practicable and consistent with over-all security assistance objectives, allied/friendly countries will be encouraged to acquire U. S. defense articles (including excess defense articles) and services through purchase rather than grant aid.
>
> I. Direct procurement of U. S. defense articles and services from U. S. firms and manufacturers is preferred to procurement from the U. S. Government. DOD elements associated with security assistance will cooperate with and assist representatives of U. S. firms in the sale of U. S. defense articles and services to meet valid country requirements, consistent with over-all U. S. foreign policy and national security objectives. (Underlining mine.)
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> L. Security assistance shall be implemented in such a manner as to mitigate adverse effects on the U. S. international balance of payments.[1]

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[1]U. S., Department of Defense, Assistant Secretary of Defense (International Security Affairs), Department of Defense Policy and Responsibilities Relating to Security Assistance, Directive No. 5132.3, December 20, 1972, pp. 2-4.

The explicit and implicit standards of performance contained in statutes, executive orders, and departmental implementing regulations are largely subjective in nature and are not easily defined and measured in operational terms. Nevertheless, such criteria provide a necessary benchmark for judging the present implementation of the foreign military sales program and for evaluating possible revisions to defense procurement policies and procedures, as the following chapters will demonstrate.

Summary

The purpose of this chapter was to portray the evolution of the Security Assistance Program, and, more specifically to respond to the question: What trends are evident in the various segments of the Security Assistance Program (grant aid, foreign military sales, and direct commercial sales) since their inception?

Through a brief review of pertinent legislative milestones and executive implementing actions, the rationale for various modes of arms transfers--grant aid, foreign military sales, and direct commercial sales--has been shown. Further, with respect to significant trends, it was demonstrated that grant aid has been on the decline, and commercial sales have been relatively small and stable, while foreign military sales have increased dramatically. Additionally, such sales in recent years have involved more complex items of equipment sometimes requiring research and development effort. There is evidence that foreign military sales will continue at a

high level in the foreseeable future, subject to any statutory changes that may result from the present Congressional scrutiny of arms sales. Finally, the federal organization for security assistance and standards of performance for the foreign military sales program have been investigated as a prelude to assessing the impact of foreign military sales on defense procurement policies and procedures in the chapters that follow.

CHAPTER IV

THE DEFENSE PROCUREMENT PROCESS AND FOREIGN MILITARY SALES

The purpose of this chapter is to explore the defense procurement process and the FMS program in order to respond to the subsidiary research question: What is the nature of the defense procurement process, what are the critical determinations to be made in effecting foreign military sales, and how do procurements for FMS differ from normal defense procurements?

In exploring the interface between defense procurement and FMS, the report examines: (1) the basic framework of the defense procurement process, (2) the establishment of the FMS agreements between the U. S. and foreign governments and between the U. S. Government and the domestic defense contractor, and (3) the major differences between FMS and normal DOD procurements. As a prelude to Chapters V and VI, the concluding section introduces a basic issue for analysis--whether FMS procurements should continue to be handled within the defense procurement framework, or whether exceptional treatment is warranted.

The Nature of the Defense Procurement Process

Before the unique features of FMS procurements are addressed, it is necessary to delve into the nature of the defense procurement process in general and to discuss certain aspects of the manner in which major weapon systems are acquired. A detailed treatment of either subject here would duplicate what has already been accomplished elsewhere and would constitute a departure from the main thrust of this report.[1]

The Commission on Government Procurement took a broad perspective of the procurement process by observing that the process differs according to the agency concerned, the goods or services required, the complexity of the action, the economic interests involved, and the laws and procedures governing the transaction. According to the Commission's report, the procurement process includes:[2]

1. Planning (forms of competition, types of contracts, and cost estimates)

2. Solicitation of sources

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[1]The reader is referred to two recent works for detailed treatment of the subject areas. The Report of the Commission on Government Procurement (Washington: U. S. Government Printing Office, December 1972) is the result of a two-year study of the federal procurement process with primary emphasis on the Department of Defense. A reference that provides a comprehansive analysis of the weapon systems acquisition process is J. Ronald Fox, Arming America: How the U. S. Buys Weapons (Cambridge, Mass.: Harvard University Press, 1974).

[2]Report of the Commission on Government Procurement, Volume 1, Appendix F, pp. 159-161.

3. Selection and award (formal advertising or negotiated procurement)

4. Contract administration

The procurement process takes place within an environment of statutes and regulations, and the determination of procurement needs and provision of funding are viewed as inputs originating outside of the process.

To refresh the reader's memory, it will be recalled that Chapter I contains the following definition of procurement taken from the Armed Services Procurement Regulation:

> Procurement includes purchasing, renting, leasing, or otherwise obtaining supplies or services. It also includes all functions that pertain to the obtaining of supplies and services, including description (but not determination) of requirements, selection and solicitation of sources, preparation and award of contracts, and all phases of contract administration.[1]

In identifying the functions associated with procurement, the above definition comes very close to describing the procurement process as viewed by the Commission on Government Procurement.

The primary source of DOD policy relating to weapon systems acquisition is Department of Defense Directive 5000.1. This document assigns responsibilities to the military departments, to the Office of the Secretary of Defense (OSD), and to the Defense Systems Acquisition Review Council regarding program initiation, management, and sequential approval at the OSD level. Although the directive concentrates on program trade-offs that must be made among technical capability, cost

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[1]ASPR 1-201.13.

and schedule considerations, selected guidance relating to procurement is contained therein:[1]

1. Contract type shall be consistent with program risk

2. Cost-reimbursement-type contracts are preferred when substantial development effort is required

3. Fixed-price-type contracts should be used when risk is sufficiently reduced to permit realistic pricing

4. Contract changes shall be limited to those that are necessary or that offer substantial benefit to DOD

By definition, major defense system programs are those that have an estimated research and development cost of $50 million or an estimated production expenditure of $200 million.[2] One important observation must be made concerning the manner in which such systems are procured:

> The policies and procedures of the Armed Services Procurement Regulation (ASPR) apply equally to the contractual aspects of systems as they do to other procurements. The basic policy of obtaining competition to the maximum extent practicable is pursued just as vigorously here as elsewhere. Similarly, small business and labor surplus area programs and other socio-economic objectives are equally emphasized. . . . There are no additional types of contracts available for special application in systems procurement.[3]

Returning to the concept of the procurement process introduced earlier, the phases identified--planning,

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[1]U. S. Department of Defense, Director of Defense Research and Engineering, Acquisition of Major Defense Systems, Directive 5000.1, July 13, 1971, p. 5.

[2]Ibid., p. 1.

[3]U. S., Department of Defense, "DOD's New Improved Procurement Program," Commander's Digest, 15 (May 9, 1974): 14.

solicitation, selection and award, and contract administration--are now examined more carefully in order to better understand the nature of the defense procurement process.

Planning has to do with the description of the item of service required, estimation of its cost, and determination of the method of procurement (formal advertising or negotiation) appropriate to the circumstances. The planning element becomes increasingly formalized as the magnitude and complexity of the proposed procurement action increases. The ASPR provides for the preparation of an advance procurement plan for negotiated development procurements estimated to exceed $300,000 in a fiscal year and negotiated production procurements exceeding $1 million during a fiscal year. No advance procurement plan is prescribed for formally advertised procurements. The regulation neither specifically includes nor exempts FMS procurements from such planning requirements.[1]

The manner of soliciting sources is closely tied to the determination of the appropriate method of procurement. The ASPR, in implementing the Armed Services Procurement Act of 1947, provides that formal advertising (sealed bidding) is the preferred method of procurement; however, the statute recognizes seventeen exceptions under which negotiation may be permitted.[2] Negotiation may include design competition and price competition. Major weapon systems are always procured by

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[1]ASPR 1-2100.2.

[2]ASPR Section II addresses Procurement by Formal Advertising and Section III, Procurement by Negotiation.

negotiation. Once a contractor is chosen for a program, "that contractor generally manufactures the initial production quantity and as a practical matter often becomes the sole source for successive production procurements."[1]

An important aspect of the defense procurement process, and one that affects all phases from planning through contract administration, is the utilization of the defense contract as a means to further national socio-economic goals as expressed in statutes and executive orders. Some of the more important objectives are the following:

1. Preference for contract awards to small businesses and minority business enterprises (10 U.S.C. 2301 and ASPR Section I, Part 7)

2. Preference for contract awards to firms in labor surplus areas (ASPR Section I, Part 8)

3. Preference for domestic products (41 U.S.C. 10 (a)-(d) and ASPR Section VI, Part 1)

4. Assurance of equal employment opportunity (ASPR Section XII, Part 8)

5. Payment of minimum wages and provision of safe working conditions (Various statutes and ASPR Section XII)

6. Renegotiation to recoup excess profits from defense contractors (50 U.S.C. App. 1211-1233 and ASPR 1-319)

These socio-economic programs are generally implemented through rules governing eligibility of contractors for award or through contract clauses requiring certain actions during

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[1]"DOD's New Improved Procurement Program," p. 6.

performance of the contract.

In the phase of the procurement process dealing with selection of the successful contractor and award of the contract, two aspects deserve mention--the type of contract to be employed and the pricing of the procurement. A formally-advertised purchase of a standard commercial item generally results in a firm-fixed-price contract with the price being determined by the lowest responsive bid submitted by a responsible offeror. Negotiated procurements are usually much more complex. When the uncertainties associated with contract performance are substantial, the use of a cost-reimbursement-type contract may be warranted. In such cases, ASPR Section XV contains elaborate cost principles which prescribe guidelines for determining the allowability, allocability and reasonableness of costs that the Government is obligated to reimburse under the contract.

The cost principles fulfill another important function in that they serve as a basis for negotiating fixed-price contracts in situations when competition is inadequate or whenever cost analysis must be employed in contract pricing. In general, the percent of profit or fee established during negotiation varies directly with the degree of risk assumed by the contractor, i.e., a higher profit percentage is allowed under a fixed-price contract than under a cost-reimbursement contract.

Contract administration in its broadest perspective encompasses all actions that take place subsequent to contract

award. As a general rule, the extent of the Government's active involvement in monitoring contract performance, including quality assurance, timeliness of delivery, and conformance with contract terms and conditions, is dependent upon the magnitude and complexity of the procurement. Monitoring contract fund status and approving payments to the contractor are always functions which demand close attention. Under cost-reimbursement contracts, interim vouchers are submitted periodically for audit (to ascertain conformance with the cost principles) and payment. Progress payment provisions under fixed-price contracts authorize periodic disbursements based on a percentage (normally eighty to eighty-five percent) of costs incurred. The increasing austerity of defense budgets coupled with the fact that interest expense is considered to be an unallowable cost on defense contracts make payment an element of vital concern to both of the contracting parties.

Despite the brevity of the preceding examination of the nature of the defense procurement process, the crucial importance of procurement regulations has been substantiated. Although many elements of the process are direct reflections of statutory requirements, the broader procurement regulations of the Department of Defense have been construed in judicial decisions to have the force and effect of law. John Grossbaum has observed that, "the bulk of the provisions of a government contract tend to be described by law and regulation," a situation that "lends credence to the view that, for the most part,

the Government contracts by regulation."[1]

The report now turns to an examination of the policies and procedures by which the FMS agreement between the U. S. and foreign government and the FMS contract between the U. S. Government and the domestic defense contractor are established.

Critical Determinations in Effecting Foreign Military Sales

Establishing the Government-to-Government Agreement

It is Department of Defense policy that an offer to sell U. S. military goods and services through government channels will be made only in response to a request initiated by a foreign government. Although U. S. military representatives stationed in foreign countries do advise the host government regarding military needs, "it is not the responsibility of the Military Assistance Advisory Group/Military Group to encourage or promote sales."[2] Consequently, FMS requests originate with the foreign government, either through country representatives in the U. S. or through the U. S. Country Team located in the foreign nation.

As indicated in the preceding chapter, the route that the request takes depends on the eligibility of the foreign country to procure U. S. military goods and services. For

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[1]John J. Grossbaum, "Procedural Fairness in Public Contracts: The Procurement Regulations," Virginia Law Review, 57 (March 1971): 183.

[2]U. S., Department of Defense, Director, Defense Security Assistance Agency, Memorandum for MAAGs/MilGroups, Subject: "Terms of Reference," January 15, 1975, p. 4.

purposes of determining whether proposed sales are consistent with U. S. foreign policy objectives, eligible purchasers have been classified. Category A nations have been pre-cleared by the Department of State and are authorized to submit requests directly to the military department responsible for the particular item. Category B country requests must be approved by the Department of State prior to any action being taken by the DOD. As a practical matter, if the particular country's request has been monitored through an exchange of messages, approval by the Department of State may be relatively routine. In addition, an officer of each U. S. military service is assigned to the Department of State to facilitate coordination with the Department of Defense concerning specific purchase requests.

A relevant determination to be made at this point concerns whether the proposed sale should be conducted as a direct commercial sale instead of as a FMS. Although it is the intent of Congress and the policy of the DOD to give preference to commercial sales, several circumstances militate against the use of this channel:[1]

1. In cases where an end item incorporates government-furnished equipment, such as engines or instruments for an aircraft, sale to private parties is precluded under existing law, and the FMS channel is dictated

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[1]U. S., Department of Defense, Defense Security Assistance Agency, Military Assistance and Sales Manual, Part III, p. D-3.

2. Classified equipment or data must be delivered through government channels only

3. Sales committing future use of the U. S. logistics system by a foreign government must be conducted through the FMS channel

4. In special situations, the U. S. Government may desire to exercise control over a sale by keeping it in the government-to-government channel

In addition, most respondents indicated that the desire of the foreign government to procure under FMS procedures is often a crucial determining factor. Reasons offered include a preference for dealing with U. S. Government-as opposed to private industry-representatives, a lack of purchasing expertise on the part of the foreign government, and a desire to acquire follow-on logistical support through government channels.

Having determined that a FMS case is appropriate, the military department responsible for the item or service performs a pricing and availability study prior to tendering an offer to the foreign country. Using a current production aircraft as an example, the Air Force would prepare an estimate of the total price and a delivery schedule, normally in consultation with the prime contractor. Pricing computations would include elements such as the airframe, contractor-furnished equipment, government-furnished equipment, data, delivery charges, accessorial charges, administrative costs, and, in some instances, a pro-rata share of the nonrecurring research,

development, and production costs associated with the aircraft.[1]

Prior to forwarding an offer to the foreign government, the military department may be required to obtain the concurrence of the Defense Security Assistance Agency (DSAA) and of the Congress. The DSAA requires that approval be obtained for letters of offer in the following categories:[2]

1. Sales to Latin American and African countries[3]
2. Sales of major weapon systems
3. Sales of end items with a value exceeding $5 million
4. Sales involving a surcharge for nonrecurring research and development
5. Sales involving research, development, test and evaluation or for items which are not standard in the DOD inventory
6. Sales of technical data packages which could result in establishment of a foreign production capability

In addition, letters of offer for sales exceeding $25 million must be submitted to the Congress prior to being presented to the foreign government. Congress has twenty calendar days to consider the proposed sale and may register its objection by

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[1]U. S., Department of the Air Force, Foreign Military Sales, Air Force Manual 400-3, May 7, 1974, para. 8-37.

[2]Military Assistance and Sales Manual, Part III, p. D-4.

[3]This particular approval category was established because of regional sales ceilings imposed on Latin America and Africa by the Foreign Military Sales Act of 1968. The ceiling on Latin America was repealed by Section 45(a)(8) of the Foreign Assistance Act of 1974, P.L. 93-559, approved December 30, 1974.

passing a concurrent resolution.[1]

The document used to consummate the government-to-government sales agreement is the Letter of Offer and Acceptance, DD Form 1513, including the general conditions on the reverse of the form. A copy of the Letter of Offer and Acceptance is at Appendix E. Although additional terms and conditions may be made a part of the agreement, the most pertinent obligations of the parties in a standard case are as follows:

1. The United States Government:

a) Agrees to procure items or services under the most advantageous terms and conditions available employing the same contract clauses, the same contract administration, and the same inspection procedures as DOD uses in procuring in its own behalf, except as requested by the purchaser and agreed to by DOD

b) Advises that special warranty terms must be requested and paid for by the purchaser if desired

c) Agrees to correct deficiencies existing prior to passage of title

d) advises that the prices of items and delivery projections are estimates and that the final price will represent the total cost to the U. S. Government

e) Reserves the right to cancel the order prior to delivery and to pay the resulting termination costs

2. The Purchaser:

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[1]The Foreign Assistance Act of 1974, sec. 45(a)(5).

a) Agrees to make payment in U. S. dollars under the cash or credit terms specified in the agreement

b) Shall furnish shipping instructions and obtain export licenses for items not exported by the U. S. Government

c) Shall accept title at the point specified in the agreement

d) Shall reimburse the U. S. Government if the final cost exceeds the estimate in the agreement

e) May cancel the order prior to delivery and pay any resulting costs

f) Shall use items only for purposes specified in applicable defense agreements or treaties, or for internal security, self-defense, or civic action if no defense agreement or treaty governs such use

g) Shall not transfer articles to any third party unless the written consent of the U. S. Government has first been obtained

h) Agrees to provide protection for classified security material equivalent to that employed by the U. S. Government and to respect any proprietary rights in defense articles, plans and specifications

i) Agrees to indemnify the U. S. Government against injury or death, damage to property, or patent infringement in connection with the agreement; and to relieve U. S. contractors from liability for loss or damage to the purchaser's property

The letter of offer is forwarded to the foreign government which normally has ninety days to accept or reject it.

Assuming that the offer is accepted, the appropriate military department prepares implementing instructions and forwards the accepted case to the sub-command responsible for stocking or procuring the requested article or service. For example, a request for a current production Air Force aircraft would be forwarded by Headquarters, U. S. Air Force to the Air Force Systems Command which would in turn assign the case to the Aeronautical Systems Division for procurement action.

It should be noted that the consummation of the government-to-government agreement to this point has been handled by the organizational element of the particular military service that is responsible for security assistance--Military Assistance and Sales within the Air Force, the Security Assistance Division under the Chief of Naval Operations, or the Army's International Logistics Directorate. With the possible exception of participation in the pricing and availability study, personnel responsible for procurement have been minimally involved. This aspect, which sometimes creates communication problems that hamper the subsequent procurement action, is discussed in greater depth in the following chapter.

Establishing the Agreement Between the U. S. Government and the Domestic Defense Contractor

As indicated in the preceding section, once the government-to-government agreement has been established by the foreign country's acceptance, the U. S. Government is then committed: (1) to procure the requested items under the most advantageous terms and conditions available consistent with DOD

regulations and procedures, and (2) to employ the same contract clauses, contract administration, and inspection procedures as DOD uses in its own procurements except as otherwise requested by the purchaser and agreed to by the DOD. In other words, the Letter of Offer and Acceptance may specify that particular clauses or procedures will be employed in making the purchase.

The purpose of this section is to describe the existing policies and procedures which govern procurements for FMS so that the differences between such procurements and normal DOD purchases can be ascertained and analyzed. The primary sources of regulatory guidance within DOD concerning the unique features of FMS procurement are the following:

1. The Armed Services Procurement Regulation (ASPR)
2. Defense Procurement Circulars which are ASPR revisions
3. The Contract Pricing Manual incorporated in the ASPR
4. Department of Defense Directives and Instructions issued by various OSD staff elements in particular subject areas

The source of each policy or procedure cited as being unique to FMS procurement is identified.

Precedence of treaties and executive agreements

The ASPR recognizes that treaties or executive agreements with foreign nations take precedence over procurement regulations by authorizing deviations necessary to comply with

such treaties or agreements without recourse to the normal procedure prescribed for obtaining deviations.[1] However, other ASPR deviations proposed for use, such as payment arrangements that differ from normal DOD practice, must ordinarily be forwarded through departmental channels in order to secure approval for the deviation prior to award of the FMS contract.

Source selection guidelines

The right of the foreign government to specify in the letter of offer a particular manufacturer or source of supply for the item being purchased is noted in the ASPR. When a sole source is designated, the military department is authorized to make the purchase without further approval.[2]

Also with regard to sources of supply, the ASPR cautions that an FMS procurement will not be made on behalf of any economically-developed nation when the requested article is available from commercial sources within the U. S., a requirement imposed by the Foreign Military Sales Act.[3]

Pricing FMS procurements

The ASPR states that the Department of Defense assumes responsibility to pay no more than a fair price for the item

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[1]ASPR 1-109.4. [2]ASPR 6-705.5.

[3]Although the provisions of ASPR 6-705.2(a) remain in effect, the Foreign Assistance Act of 1973, P.L. 93-189, approved December 17, 1973, repealed the provision dealing with the use of U. S. commercial sources by economically-developed nations in favor of the more general mandate referred to in the preceding chapter, i.e., to reduce foreign military sales to the maximum extent and to return such transactions to commercial channels as rapidly as possible.

being procured for the foreign government and that the same degree of care will be used to price FMS and DOD procurements.[1] The Contract Pricing Manual adds that, "although there may be new or unfamiliar areas of cost that must be considered, there is the same requirement for cost or pricing data and the principles regarding competition, price analysis and cost analysis apply to these sales to the same extent they apply to sales for United States Government consumption."[2]

This does not mean that the same price would result on FMS and DOD purchases for the same item since certain kinds of costs may be allocated to FMS contracts that would not be included in purchases for DOD. Examples of additional cost factors that are allowed in FMS procurements include:[3]

1. Selling costs including maintenance of international sales and service organizations and sales commissions and fees

2. Product support and post-delivery service costs

3. Costs of translating technical manuals and comparable material

Costs that are unallowable in DOD procurements, such as entertainment costs, are also unallowable in FMS contracts.

Agent's fees in FMS contracts

Several ASPR provisions relate to the allowability,

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[1]ASPR 6-705.3.

[2]U. S., Department of Defense, Assistant Secretary of Defense (Installations and Logistics), Contract Pricing Manual, Armed Services Procurement Manual No. 1, February 14, 1969, p. 17-1.

[3]ASPR 6-705.3.

allocability and reasonableness of sales commissions and agent's fees in FMS procurements. One of the ASPR cost principles provides that such fees which are contingent upon contract award are allowable only, "when paid to bona fide employees or bona fide established commercial or selling agencies maintained by the contractor for the purpose of securing business."[1] Allocability is determined in light of the reasonable benefit to the government arising from activities such as consultation and demonstration by the agent. Supplementary guidance issued in a Defense Procurement Circular provides that the primary test of reasonableness of an agent's fee "is an assessment of the services provided compared to the amount of the fee."[2] The circular suggests comparison of proposed fees with those paid on other FMS or commercial sales of the same or similar item in comparable amounts. If reasonableness cannot be established based on such a comparison, the contractor is to be required to provide a cost breakdown of the proposed fee in relation to the services rendered. In any event, an agent's fee exceeding $1 million requires approval of the proposed FMS contract by the headquarters of the military service.

An additional provision of the same Defense Procurement Circular specifies that no agent's fee shall be allowed in contracts for FMS requirements of the Government of Iran unless

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[1]ASPR 15-205.37(c).

[2]U. S., Department of Defense, Assistant Secretary of Defense (Installations and Logistics), Defense Procurement Circular, No. 117, November 23, 1973, Item VIII, p. 22.

the payment thereof has been approved by the Iranian Government prior to contract award.[1]

Special profit consideration for FMS

Contractors actively engaged in the development of foreign markets for military items who exert sales efforts and assume risks beyond normal may deserve special profit consideration according to the ASPR.[2] An additional profit factor of between one and four percent of recognized costs may be established on the basis of criteria such as: (1) the demonstrable initiative of the contractor in furthering such sales, (2) the responsibility assumed by the contractor for the product after delivery, and (3) other attendant risks. The regulation implies that a minimum of one percent additional profit is to be allowed on FMS procurements.

Recovery of certain nonrecurring and recurring costs

The ASPR states that it is Department of Defense policy to recoup a share of the nonrecurring costs associated with major defense equipment when such equipment is sold to a buyer other than the U. S. Government. Examples of nonrecurring costs include research, development, testing, facilities, special tooling, and product improvement. An allocation of the total estimated nonrecurring charges over the total projected production run is made, and the FMS purchaser is required to reimburse DOD for the pro-rata share of nonrecurring costs

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[1]Ibid., Item IX, p. 23. [2]ASPR 3-808.6(b).

associated with the FMS procurement. The regulation also provides that such recoupment may be waived by the Secretary of Defense or his designee if in the interests of the U. S. Government.[1]

A DOD instruction specifies that FMS procurements for current production will be charged on either a direct of pro-rata basis for recurring support costs incurred by the U. S. Government in conducting such procurements.[2] Examples of such recurring costs include government-provided material and engineering services, quality assurance, production testing, transportation and packing, administrative charges, and recurring technical documentation costs. The ASPR has not yet been amended to provide for the recoupment of these recurring support costs through direct or pro-rata charging under the production contract. However, the Military Assistance and Sales Manual does provide that accessorial charges for transportation and packing and administrative charges will be applied as separate surcharges in establishing the price appearing in the letter of offer.[3]

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[1]ASPR 4-109.

[2]U. S., Department of Defense, Assistant Secretary of Defense (Comptroller), Pricing of Sales of Defense Articles and Services to Foreign Countries and International Organizations, Instruction No. 2140.1, January 29, 1970.

[3]Military Assistance and Sales Manual, Part III, p. D-5.

Options for FMS requirements

A 1972 decision of the Comptroller General of the United States found that the U. S. Army had improperly exercised an option under an existing production contract to fulfill FMS requirements.[1] The existing contract in question did not indicate that the option clause might be exercised to fulfill FMS requirements. As a consequence of the ruling, the ASPR was amended to provide that, "a FMS commitment undertaken by the U. S. Government on behalf of a foreign country is considered fulfillment of an existing need of the U. S. Government."[2] It was intended that this statement would constitute adequate notice to contractors that FMS requirements might be fulfilled through exercise of contract options in the future.

Rent-free use of Government production and research property

On FMS procurements, rent-free use of government production and research property in the hands of the domestic contractor is normally authorized as a reflection of DOD policy. The contractor's competitive position is improved by enabling him to charge a lower price for the item, and the purchaser is subsidized by the use of U. S. Government property without charge. The ASPR extends this policy to direct commercial sales by allowing, on a case-by-case basis, rent-free use of government production and research property when

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[1]Comptroller General of the United States, Decision B-174725, June 16, 1972, pp. 25-26.

[2]ASPR 1-1505(c)(ii).

such use would not interfere with U. S. Government requirements and would not enhance the competitive position of the contractor.[1]

Limitation of liability under FMS contracts

The preceding section indicated that a standard condition of the DD Form 1513 deals with the foreign government's assumption of risk for loss or damage to the purchaser's property occurring before or after passage of title to the purchaser just as the U. S. Government would do if purchasing in its own behalf. When the foreign government agrees to this standard provision, a clause is inserted in the FMS contract to limit the contractor's liability for the property of the purchaser, including the items to be delivered under the contract. When the foreign government will not assume the risk for loss or damage, the ASPR provides that: (1) the contractor will be so advised, (2) insurance may be obtained by the contractor to cover the risk, and (3) the cost of insurance will be considered in pricing the items under the contract.[2]

Summary

Examination of the unique regulatory provisions governing FMS procurements made on behalf of a foreign country reveals a somewhat fragmented collection of policy and procedural statements. These unique provisions were issued in response to: (1) legislative requirements, (2) policies and procedures

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[1]ASPR 13-406. [2]ASPR 6-705.6.

pertaining to the Letter of Offer and Acceptance, and (3) specific problems or deficiencies noted in conducting FMS procurements over the years. In the following section, significant differences between FMS and normal defense procurements are analyzed.

Significant Differences Between FMS and DOD Procurements

In analyzing the major differences between procurements made for the benefit of a foreign government and normal defense procurements, the general approach of the preceding sections is continued. Exogenous factors are discussed initially followed by differences found to exist in each phase of the procurement process--planning, solicitation of sources, selection and award, and contract administration.

Factors Exogenous to the Procurement Process

The most important exogenous consideration is the fact that the ultimate consumer of the good or service being procured is a sovereign entity outside the U. S. Government which has contracted to employ the defense procurement process for a specific task. The motivations and expectations of the foreign customer may be very different from those of domestic defense procurement customers. The substitution of a foreign user alters the predictability of traditional buyer-seller relationships and increases the importance of political and foreign policy considerations.

In the first section of this chapter, procurement needs

and funds were depicted as being inputs to the defense procurement process. When contracting for FMS is involved, needs determination and funding become factors that are even further removed from the process. As for determining needs, a study by the Stockholm International Peace Research Institute (SIPRI) sheds some light on the factors that influence the demand for arms by the third world nations, i.e., those outside NATO and the Warsaw Pact:[1]

1. Perceived military requirements in response to internal or external threats

2. Affirming national identity through acquisition of arms

3. Gaining internal support of armed forces by satisfying their demands for weapons

4. Sufficient foreign exchange earnings to devote to arms

5. The influence of major arms suppliers

Although the process for determining military needs, particularly for major weapon systems, employed by our NATO allies may sometimes approximate the extensive DOD process, the requirements of other foreign customers are likely to have been subjected to much less scrutiny.[2] In other words, the

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[1]Stockholm International Peace Research Institute, The Arms Trade with the Third World (Stockholm: Almqvist and Wiksell, 1971), pp. 42-43.

[2]For an in-depth treatment of DOD's approach to requirements determination the reader is referred to: U. S., General Accounting Office, The Process for Identifying Needs and Establishing Requirements for Major Weapon Systems in the Department of Defense, B-163058, October 23, 1974.

suitability of the requested item and the country's ability to operate it may not be assured in all instances.

In a similar vein, funding of FMS procurements may be a troublesome aspect. Even though cash sales presently exceed credit sales by a ratio of almost ten to one, and FMS customers are required to agree to a dependable undertaking to pay the total cost of the procurement, difficulties may still arise. The level of sophistication of the FMS customers' budgeting systems varies greatly, and a requirement to provide additional funds to finance the increased cost of an FMS purchase may confront the procurement process with economic and political problems extending beyond domestic boundaries.

As alluded to in the preceding section, existing treaties or executive agreements between the U. S. and foreign governments or special terms and conditions made a part of the letter of offer may constitute exogenous factors. Any phase of the procurement process may be affected depending on the nature of the specific agreement and its impact.

Differences in the Planning Phase

It is rare that advance procurement planning as contemplated by the ASPR can be accomplished for FMS procurements. The principal reason is that the decision to purchase is made by a foreign government generally with insufficient lead time to permit the procurement to be placed in the planned buy for the fiscal year. It is more likely that the short notice preceding an FMS procurement may disrupt or cause alteration of

existing advance procurement plans. The lack of planning discipline is compounded in major systems procurements when sub-systems or government-furnished equipment also require long lead time decisions and funding.

Soliciting Sources for FMS Procurements

The major area of difference between FMS and DOD procurements with respect to solicitation of sources has to do with the authority to purchase on a sole-source basis. In the case of a foreign government's designation of a single source for the requested item or service, the negotiation authority of 10 U.S. Code 2304(a)(10) may be cited and "no additional approval to purchase on a sole-source basis is required."[1] When a DOD sole-source procurement is contemplated, specific justification must be provided, written determinations and findings must be prepared, and approval above the level of the contracting officer may be required prior to award of the contract.[2]

As noted in the previous section, the ASPR continues to caution against FMS procurements being made on behalf of economically-developed nations when such articles are available from commercial sources in the United States. The repeal of the underlying statutory prohibition and the substitution of the more stringent mandate, i.e., to return transactions to commercial channels and to reduce FMS to the maximum extent, appears to require more definitive guidance than the present

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[1]ASPR 6-705.5. [2]ASPR 3-210.

regulations offer.[1]

With the exception of sole-source designations by the foreign governments and the periodic diversion of requested purchases into commercial sales channels, FMS procurements generally are solicited on the same basis as DOD purchases. Identical methods of procurement and contract types are employed.

Selecting the Contractor and Awarding the FMS Procurement

The phases of the procurement process having to do with contractor selection (including contract pricing) and contract award are the areas where the greatest differences between FMS and DOD procurements are evident. The cost principles and pricing procedures, including price and cost analysis, set forth in the ASPR are generally applicable to FMS procurements; however, there are several special areas of consideration including the following: (1) costs of doing business with a foreign government, (2) rules governing agent's fees, (3) special profit factor for FMS, (4) recoupment of nonrecurring research, development and production costs, (5) exercise of contract options for FMS, and (6) rent-free use of government-furnished production and research property.

1. When cost analysis is required in pricing a FMS procurement, the ASPR provides that:

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[1]Section 1 of the Foreign Military Sales Act of 1968 was amended by the Foreign Assistance Act of 1973, P.L. 93-189, approved December 17, 1973.

> Recognition should be given to costs of doing business with a foreign government (even though the form of the transaction is a Defense procurement for the purpose of Foreign Military Sales) whenever comparable costs of doing business with the United States would be recognized in pricing normal Defense contracts. Thus, recognition should be given to reasonable and allocable costs even though they might not be recognized in the same amounts in pricing normal Defense contracts.[1]

Examples of such costs include maintaining foreign sales and service organizations, product support, and translating technical manuals. Alternatively, cost categories that are not allowable under the ASPR cost principles are also not allowable in pricing the FMS procurements.

2. The payment of agent's fees on FMS procurements has been the subject of regulatory guidance over and above that provided concerning commissions and fees on domestic defense contracts. The need for such supplementary guidance has been a result of the more temporary nature of overseas agency relationships and the fact that the application of small commission rates on FMS of large dollar value have resulted in exorbitant fees. The unique ASPR provisions related to allowability of agent's fees on FMS have been aimed at (a) establishing that a bona fide agency relationship does exist, and (b) determining that the amount of the fee is reasonable in comparison to the services performed.

3. A special profit consideration ranging from one to four percent on FMS procurements is deemed appropriate in recognition of outstanding sales efforts by the contractor in

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[1]ASPR 6-705.3(c).

foreign markets and attendant risks associated with such marketing endeavors. However, to qualify for such special profit consideration, the contractor should demonstrate initiative in furthering sales and should assume some degree of responsibility for the product subsequent to delivery.[1] The FMS special profit factor is over and above any profit considerations related to normal DOD procurements.

4. Another area of difference between FMS and DOD procurements has to do with the recoupment of certain nonrecurring costs associated with major defense equipment when such equipment is sold to foreign buyers. The purpose of the DOD policy is to recover a pro-rata share of investment costs since the buyer is receiving benefit of the research and development that the Department of Defense has already conducted. Nevertheless, the recoupment of nonrecurring research, development and production costs may be waived by the Secretary of Defense or his designee when it is clearly demonstrated "that approval [of a waiver] would be in the interests of the United States Government."[2]

5. In awarding normal defense contracts for production of major equipment, priced option quantities are sometimes made a part of the agreement to facilitate the procurement of additional requirements which later become known. In 1973, the ASPR was revised to permit the exercise of such options to fulfill FMS commitments undertaken by the U. S. Government. The intent of the revision was to give notice to industry that

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[1]ASPR 3-808.6(b). [2]ASPR 4-109(e).

FMS requirements might be fulfilled through exercise of contract options.

6. Rent-free use of government production and research property by a domestic contractor constitutes a unique feature of FMS procurements. Although such use is granted on the basis that FMS procurements are made under rules governing U. S. defense purchases, the extent of such rent-free use represents a subsidized sale that benefits both the domestic contractor and the foreign buyer. The ASPR extends this policy to direct commercial sales made to a foreign government by permitting, on a case-by-case basis, rent-free use of government production and research property for the purpose of encouraging foreign sales. In addressing the use of government property in domestic situations, the ASPR provides that government property may be used to benefit U. S. Government contracts other than the contract for which the property was provided; however, non-government, commercial use is normally permitted on a rental basis only.[1]

The apparent inconsistency between DOD policies that: (1) seek to recoup a share of nonrecurring research, development and production costs including facilities and special tooling, and (2) authorize rent-free use of government production and research property to encourage foreign sales, is examined in the following chapter.

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[1]ASPR 13-401 through 13-406.

Contract Administration for FMS Procurements

The ASPR does not provide any unique guidance relative to performance of contract administration services for FMS. It is presumed that contract administration for FMS procurements is to be performed just as if the purchase were a normal DOD procurement as the Letter of Offer and Acceptance specifies. There are, however, several features of FMS procurements that constitute differences from normal contract administration such as the following:

1. The termination or cancellation of an FMS procurement can be initiated by either the U. S. Government or the foreign government, and the rights and obligations of the parties are likely to be more difficult to discern than in a normal two-party situation

2. Financing arrangements necessitate collecting from the foreign government as well as disbursing to the contractor

3. Foreign governments sometimes request that the U. S. Government perform inspection services on direct commercial sales when inspectors are already involved with performing quality assurance on DOD and FMS procurements

4. The resolution of indemnity or liability problems on FMS procurements may involve the foreign government or insurance companies whereas, on normal defense procurements, the U. S. Government would act as a self-insurer

5. Post-delivery services to be performed by the contractor may result in further U. S. Government involvement even though shipment has been completed

Summary

This chapter has explored the defense procurement process and the FMS program for the purpose of responding to the subsidiary research question: What is the nature of the defense procurement process, what are the critical determinations to be made in effecting foreign military sales, and how do procurements for FMS differ from normal defense procurements?

The defense procurement process has been characterized as being governed largely by statutes and agency regulations that have the force and effect of law. The entire process is strongly oriented toward maintaining integrity and accountability in the expenditure of public funds. Accomplishment of this objective is sought by spelling out in great detail rules governing eligibility for contract award, contract placement procedures, cost principles, and the like. Major weapon systems are acquired under the same regulations, methods of procurement, and types of contracts as other goods and services that are purchased by DOD.

Critical determinations in effecting FMS have been identified. The government-to-government agreement is established through a request initiated by the foreign government, a pricing and availability study prepared by the appropriate military department, and a Letter of Offer and Acceptance (DD Form 1513) describing the terms and conditions of the agreement. Subsequently, the FMS contract between the U. S. Government and the domestic defense contractor is established within the basic framework of the defense procurement process

as modified by the policies and procedures unique to FMS procurements that have been described.

The significant differences between policies and procedures governing FMS procurements and those governing normal DOD purchases have been identified and analyzed. A consideration of exogenous factors reveals that FMS procurements are conducted for the benefit of a sovereign entity outside the U. S. Government whose procurement needs and funding are determined independently of the defense procurement process.

The phases of the procurement process--planning, solicitation of sources, selection and award, and contract administration--have been modified to various degrees to accommodate FMS procurements. The planning of procurement actions is complicated by the fact that FMS requirements may be made known in insufficient time to enter into the formalized process for planning significant negotiated procurements. In soliciting sources, the ASPR recognizes that the foreign government may desire to specify a sole source for a particular requirement and also calls attention to the preferred use of commercial sources under certain conditions. The phase dealing with selection of the contractor and award of the contract is the primary area where differences between FMS and DOD procurements are reflected. Provision has been made for recognizing the cost of doing business with a foreign government, rules governing agent's fees have been expanded, a special profit factor has been established, and policies concerning recovery of nonrecurring costs, exercise of contract options,

and authorizing rent-free use of government property have been promulgated. Although unique guidance concerning contract administration for FMS is not in evidence, several instances have been identified wherein contract administration for FMS differs from contract administration for DOD procurements.

Analysis of the differences between policies and procedures governing FMS and DOD procurements suggests that an attempt has been made to accommodate foreign military sales within the basic framework of the defense procurement process to the maximum extent possible. In other words, unique provisions of the regulations dealing with FMS procurements have been reserved for areas that the DOD considered worthy of special coverage. As indicated, unique guidance has been prepared in response to: (1) statutory requirements, (2) the terms and conditions of the Letter of Offer and Acceptance (DD Form 1513), and (3) problems associated with FMS procurements. An evaluation of the degree to which such an approach has been successful must take into account the present problems being experienced that are related to policies and procedures governing FMS procurements. These problems are identified and analyzed in the following chapter.

The analysis of problems associated with FMS procurements presented in the subsequent chapters calls into question the current approach for procuring FMS requirements on behalf of foreign customers--the adaptation of the basic defense procurement process to the task with only minimal unique treatment. The increased volume and complexity of FMS in recent

years coupled with the problems identified in the following chapter require reconsideration of the present approach. In evaluating any alternatives that may be proposed, the anticipated impact on the parties involved as well as the criteria for the FMS program identified in the preceding chapter must be taken into consideration. The report now turns to the identification and analysis of the major problems associated with FMS that affect defense procurement policies and procedures.

CHAPTER V

IDENTIFICATION AND ANALYSIS OF MAJOR PROCUREMENT PROBLEMS ASSOCIATED WITH FOREIGN MILITARY SALES

The objective of this chapter is to identify and analyze significant problems associated with FMS in relation to the existing policies and procedures that govern such procurements. Specifically, the content of this chapter responds to the subsidiary research question: What are the major problems associated with FMS that affect defense procurement policies and procedures?

The analysis follows the pattern established in the previous chapter. Problem areas associated with exogenous factors are examined first followed by those associated with each phase of the procurement process--planning, solicitation of sources, selection and award, and contract administration. It should be noted that the problem areas identified are not discrete and that the categorization is somewhat arbitrary in this regard. For example, a discussion of pricing to insure full cost recovery involves the planning phase (preparing the pricing and availability study and the letter of offer) as well as the selection and award phase (pricing the FMS contract). Nevertheless, the use of the structure facilitates identification and analysis of the pertinent issues.

Problems Associated With Exogenous Factors

Funding and needs determination were described in the previous chapter as exogenous factors influencing the procurement process; however, certain aspects were found to have a direct bearing on procurement policies and procedures for FMS. This section explores such aspects.

Alternative Approaches to Funding FMS Procurements

Although funding was identified earlier as an exogenous influence upon the defense procurement process, there are certain ramifications of the manner in which funding transactions are handled in FMS contracts that have a direct effect on procurement policies and procedures. The Foreign Military Sales Act provides that, "the President may, without requirement for charge to any appropriation or contract authorization otherwise provided, enter into contracts for the procurement of defense articles or defense services" for the purpose of making foreign military sales.[1] The foreign government must provide the U. S. with a dependable undertaking to pay the full amount of the procurement and to make funds available to meet contract payments or to cover any damages or costs that may result from contract cancellation. The statute further provides that appropriations available to the Department of Defense may be used to meet contract payments with subsequent reimbursement by the foreign government.

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[1]The Foreign Military Sales Act of 1968, sec. 22, 22 U.S.C., sec. 2762.

Separate trust funds have been established for each military department to account for payments received from foreign government customers and disbursements made to suppliers under FMS procurements. "These funds can be either cited directly on contracts for FMS items for that customer or can be used to reimburse military department appropriations for deliveries (or progress payments made) of items initially procured by those appropriations."[1] In other words, direct citation involves the obligation of foreign funds from the trust account, whereas reimburseable transactions initially cite U. S. appropriated funds which are subsequently replaced by foreign trust funds.

According to the DOD instruction governing FMS funding, the full amount of all firm FMS orders received pursuant to Section 21 (sales from stock) and Section 22 (procurement for sales) of the Foreign Military Sales Act, whether on a cash or dependable undertaking basis, "is recorded and accounted for as obligational (i.e., contract) authority."[2] This permits the military department to take procurement action to fulfill the order whether or not the entire dollar amount has been deposited by the foreign government.

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[1]Military Assistance and Sales Manual, Part III, p. G-1.

[2]U. S., Department of Defense, Assistant Secretary of Defense (International Security Affairs), Method of Financing, Funding, Accounting, and Reporting for Foreign Military Sales to Friendly Foreign Governments and International Organizations, Instruction No. 2110.29, September 24, 1970, as amended, p. 3.

Even though each military department has one central office that handles FMS collections and disbursements, there are differences in funding procedures among the departments and even within the same department.

The Navy International Logistics Control Office (NAVILCO) is the central activity concerned with that department's FMS financial control and accounting. According to a recent internal DOD report, "direct citation of trust funds is the method most commonly used by the Navy to finance procurement of material or services from commercial contractors for direct delivery to customers."[1] Respondents to this research stated that the individual commands have the flexibility to choose the FMS funding method that best suits their needs. Thus, the Naval Air Systems Command uses the direct citation procedure almost exclusively, while the Naval Sea Systems Command favors the reimburseable approach. The Naval Air Systems Command's preference for direct funding is based on the simplicity inherent in citing the foreign funds directly on FMS procurements. In the case of the Naval Sea Systems Command, a portion of that organization's FMS activity is conducted on an in-house basis, and the use of Navy funds for both FMS and Navy effort facilitates project management for the command.

For the most part, Army procurement activities employ

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[1]U. S., Department of Defense, Logistics Systems Compatability Review Group, International Logistics Program Systems Review, May 1975, p. VI-8.

the reimburseable approach in funding FMS procurements.[1] The Army's International Logistics Center (USAILC) receives and disburses foreign funds to reimburse Army appropriations cited in FMS procurements.

The Air Force Accounting and Finance Center (AFAFC) is the central FMS accounting and control activity for that department. Most Air Force FMS procurements are funded on a reimburseable basis. The AFAFC provides consolidated billing and collection for each foreign customer on a monthly cycle. Air Force regulations permit direct citation of foreign funds for procurement of nonstandard items and "any other FMS case if it is determined that this type of financing will expedite procurement of the item or service involved."[2] In the few instances when direct citation is employed, funding is allocated, controlled and reported on a case-by-case basis.

Certain aspects of the funding procedures described above have a direct impact on defense procurement policies and procedures regarding FMS. In particular, the DOD study cited previously found that the FMS funding environment is conducive to standardization and recommended that FMS billing and collection procedures be standardized among the military departments.[3] Of specific interest from a procurement

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[1]Ibid., pp. VI-3, VI-4.

[2]U. S., Department of the Air Force, Foreign Military Sales, Air Force Manual 400-3, May 7, 1974, para. 8-2d.

[3]International Logistics Program Systems Review, p. II-3.

standpoint is the achievement of a better understanding of the legal implications of the direct citation and reimburseable approaches to FMS funding. Since the latter procedure involves the initial use of U. S. appropriated funds while the former does not, a question arises as to the applicability of certain statutory and regulatory requirements in instances when foreign funds are cited directly in FMS procurements.

For example, the applicability of the Renegotiation Act (50 U.S.C. App. 1211-1233) to certain FMS procurements has been determined on the basis of the funds cited in the contract. The Renegotiation Board, under its regulations, considers procurements made pursuant to the authority of the Foreign Military Sales Act to be contracts "connected with the national defense" and therefore, not exempt on that basis.[1] However, in further interpreting its regulations, the Board has held that: (1) FMS procurements funded directly with foreign trust funds are exempt under the statute, while (2) FMS contracts funded with U. S. appropriated funds that are subsequently reimbursed by the foreign government are renegotiable contracts that would be considered in determining whether the contractor is subject to renegotiation for the period involved.

Whether standardization in FMS funding is attempted or not, the legal implications of each approach need to be fully explored, and procurement policies and procedures ought to be clarified in this regard.

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[1]U. S., Renegotiation Board Regulations, 32 C.F.R. 1453.5(b)(3).

Another aspect of FMS funding which is of interest with respect to procurement policies and procedures and one that is related to the topic of needs determination is the requirement for funds to permit procurement of long-lead time items. The processing time for an FMS procurement involves preparing a pricing and availability study, responding to the foreign country with a letter of offer, awaiting acceptance of the offer, and obtaining implementation authority and funding. One result is that procurement of long-lead time components of the end item cannot be initiated until these preliminary steps have been accomplished.[1] There is an apparent need for funding to cover such items to be submitted concurrently with acceptance of the letter of offer in order to facilitate the procurement of long-lead time components.

Needs Determination in FMS Procurements

Another exogenous factor in the defense procurement process is the determination of needs by the ultimate user. As alluded to in the preceding chapter, advance procurement planning efforts are often frustrated by the introduction of FMS requirements. While the U. S. programming/budgeting cycle is well understood by defense contractors as well as DOD planners, foreign government procurement requests are often "out of cycle" and may be submitted for information purposes

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[1]U. S., Department of the Air Force, Deputy Chief of Staff/Systems and Logistics, Directorate of Military Assistance and Sales, Security Assistance Impact Study, December 1974, Panel D, Task A, p. 2.

only. Respondents indicated that many letters of offer are never accepted. In fact, one command representative reported an acceptance rate of less than fifty percent. This aspect complicates planning by the system program or item manager for both FMS and domestic needs.

A related aspect of needs determination that affects the procurement process has to do with the receipt of small-quantity requests on a random basis. In other words, country A may order three units of an end item followed by country B's order for three units sixty days later. An opportunity to consolidate such requirements would normally result in a more favorable price for each customer due to the combined quantity, in reduced procurement workload for the military department, and in better production planning for the contractor. In instances when an initial consolidated purchase is not feasible, the use of flexible contracting techniques such as options and indefinite quantity type contracts might be employed to obtain the benefits of larger quantity buys and to increase the responsiveness of the procurement process to FMS requirements.[1]

Difficulties Encountered in the Planning Phase

To the extent that advance procurement planning for FMS requirements can be accomplished at all, such planning would, of necessity, take place during the preparation of the pricing and availability study and the finalization of the letter of offer. Problems associated with these steps are discussed in

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[1]Security Assistance Impact Study, Panel D, Task N, pp. 1-2.

this section.

Preparing the Pricing and Availability Study

One area of concern has to do with the limited involvement of procurement personnel in the preparation of the pricing and availability study leading to the letter of offer. To begin with, the preparation time allowed is extremely short. The DOD has established six weeks as the maximum time for furnishing an offer to a customer. The Air Force normally allows four weeks; however, considering the processing time through channels, the office preparing the response has approximately two weeks to complete it.[1] The amount of time available for obtaining price and delivery information from the prospective contractor is likely to be exceedingly short. Nevertheless, in the case of a sole-source procurement expected to exceed $10,000, the ASPR provides that, "before the Department of Defense furnishes prices for information purposes to potential foreign customers, prices shall be requested from the prospective source and such request shall state that it is for information for the purpose of Foreign Military Sales and shall identify the customer."[2]

In the actual preparation of pricing and availability studies for major weapon systems, the program/project office may make its own estimate with or without the participation of

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[1]U. S., Department of the Air Force, Foreign Military Sales, Air Force Manual 400-3, May 7, 1974, para. 5-6b.

[2]ASPR 6-705.2(b).

procurement personnel, or may obtain a planning or budgetary-type estimate from the prospective contractor. In any event, such pricing information is likely to be inadequate for actual contract negotiation purposes, a factor which sometimes results in upward revision of the estimated price contained in the letter of offer subsequent to award of the FMS contract.

Another factor complicating the timely preparation of pricing and availability studies is the fact that requests for the same weapon system vary widely from customer to customer. Specific sub-systems, unique spare parts, and support equipment are often tailored to individual country requirements. One Air Force program office indicates that the same configuration of the particular weapon system has not been priced to more than one customer.[1]

In summary, the Defense Security Assistance Agency wants to maintain maximum responsiveness to foreign government requests and also to avoid the need to increase the estimated cost quoted in the letter of offer.[2] As a consequence, pricing and availability studies for systems as complex as comparable DOD procurements are targeted for completion within much tighter time constraints than DOD pricing requires, and the resulting price reflected in the letter of offer is sometimes subject to upward revision.

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[1] Security Assistance Impact Study, Panel C, Task 12, p. 2.

[2] Military Assistance and Sales Manual, Part III, p. D-4.

Finalizing the Letter of Offer and Acceptance

The failure to communicate essential elements of information through the letter of offer is a significant shortcoming in FMS procurements. If the parties establishing the government-to-government agreement do not adequately convey the basic requirements of the transaction and the terms and conditions thereof, the results are likely to be delay and increased cost of the procurement. Some of the more serious shortcomings include: (1) the failure to specify a single source of supply when desired by the foreign government, (2) the omission of necessary support equipment, parts or services, and (3) the failure to indicate procedural variations that may have been agreed upon in preparing the letter of offer.

Sole-source designations of the foreign government are not always made known in the letter of offer. This omission may apply to the end item or to particular components or subsystems, such as specific radio or navigation equipment that the customer may require to maintain compatibility with existing systems and equipment. If the sole source is not indicated to the procurement organization, the result may be: (1) purchase of other than the desired item, (2) the need to justify a sole-source procurement under more stringent DOD rules, or (3) a change in source during the course of the procurement accompanied by delay and increased cost.

The letter of offer may omit elements of information regarding items or services that are desired by the foreign government but that are not included in the price of the basic

system. Examples include initial spare parts provisioning, support equipment and training. Efforts to remedy such situations are almost certain to produce delay, increased cost and embarrassment to both governments.[1]

Likewise, if modification of DOD contract clauses or procedures is desired, such as special warranty provisions or indemnity arrangements, these revisions must be specified in the letter of offer. Without knowledge of any agreement to the contrary, procurement personnel would employ normal DOD clauses and procedures as specified on the reverse of the DD Form 1513. Even when procedural revisions have been agreed to as a part of the letter of offer, such deviations affecting ASPR provisions normally require submission through departmental channels and approval at the DOD level. Any delay in seeking procedural deviations is likely to delay the procurement action as well.

All of the above examples are related to breakdowns in communications either between the two governments or within the U. S. Government. As mentioned in Chapter IV, the organizational mechanism employed in conducting FMS procurements contributes to the communication problems. While security assistance personnel are responsible for establishing the government-to-government agreement as reflected in the letter of offer, procurement personnel assume responsibility for the subsequent FMS contract. There is an apparent need for improved communication

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[1]Security Assistance Impact Study, Panel D, Task A, p. 4.

commencing in the initial stages of the transaction and carrying through to completion of the FMS procurement.

Problem Areas Related to Source Solicitation

The issues discussed in this section are all related to the selection of the channel for the sale--clarifying the definition of commercial availability, resolving the transfer of government-furnished equipment, and implementing offset purchase arrangements. In the case of the latter, the offset feature may be a major determinant of the FMS source solicited and may also influence the selection of suppliers and subcontractors by the prime contractor.

Clarifying the Definition of Commercial Availability

Prior to December 1973, the Foreign Military Sales Act of 1968 provided:

> No sales of unclassified defense articles shall be made to the government of any economically developed nation under the provisions of this section unless such articles are not generally available for purchase by such nations from commercial sources in the United States. Provided, however, That the President may waive the provisions of this sentence when he determines that the waiver of such provisions is in the national interest.[1]

The Foreign Assistance Act of 1973 deleted the above requirement and substituted the following mandate:

> In order to reduce the role of the United States Government in the furnishing of defense articles and defense services to foreign countries and international organizations, and return such transactions to commercial channels, the United States Government shall reduce its

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[1]The Foreign Military Sales Act of 1968, sec. 22.

> sales, credit sales, and guaranties of such articles, and defense services as soon as, and to the maximum extent, practicable.[1]

In response to this significant statutory change with respect to foreign military sales, the Director of the Defense Security Assistance Agency has observed:

> The direction of emphasis for approved arms sales from government-to-government channels to foreign government-to-industry channels is clearly the intent of Congress--and I can assure you that we in the Department of Defense comply fully with that intent.[2]

In recognition of the elaboration of Congressional intent, DOD military assistance advisory groups and overseas missions have been instructed to encourage foreign governments to purchase military equipment and services through commercial channels; however, the Military Assistance and Sales Manual and the ASPR have not yet been revised to reflect any policy changes regarding commercial availability. Consequently, these regulations still contain guidance implementing the earlier statutory requirement for restricting the sale of commercially-available items to economically-developed nations.[3]

The existing guidance in the Military Assistance and Sales Manual essentially provides that the following items and

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[1]The Foreign Assistance Act of 1973, sec. 25(1).

[2]LTG Howard M. Fish, USAF, Director, Defense Security Assistance Agency, "Military Exports--Today's Perspectives," Remarks before the Aerospace Industries Association meeting, San Diego, California, April 22, 1975, p. 6.

[3]Military Assistance and Sales Manual, Part III, Chapter H, and ASPR 6-705.2(a).

services are not commercially available:[1]

1. Ammunition rounds above twenty millimeters in caliber

2. Aircraft flares

3. Defense items which contain components of government-furnished equipment

4. Any defense item normally procured by the DOD which a defense contractor requests be sold through FMS channels for whatever reason, provided that such FMS does not infringe upon an exclusive licensing arrangement covering the territory in which the foreign government is located

5. Any defense item not normally procured by the DOD when the FMS is requested by the foreign government and the U. S. producer agrees, provided that an exclusive licensing arrangement is not infringed thereby

6. Any defense item or service which a foreign government insists on procuring through FMS channels by designating a sole-source producer for reasons other than price

7. Any defense item or service for the Federal Republic of Germany

In addition to the above criteria, an existing policy pronouncement reserves to the DOD the right to make any sale, regardless of the defense articles or services involved, "that is approved on a case-by-case basis by the Assistant Secretary of Defense/International Security Affairs or his designee as

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[1]Military Assistance and Sales Manual, Part III, p. H-2.

being in the best interests of the United States."[1] As a consequence of the numerous exceptions to what constitutes commercial availability, it is exceedingly difficult, if not impossible, to evaluate the extent to which commercial items are sold through FMS channels.

In light of the latest Congressional mandate and the explicit standard of performance for judging the FMS program embodied in the mandate, i.e., to return arms sales to commercial channels, it appears that a clarification of the definition of commercial availability by the DOD is in order. In addition, as a subsequent section of this chapter will demonstrate, certain issues concerning financing and payment terms for FMS contracts may also require a means of more clearly identifying commercially-available items being procured through FMS channels.

Issues Related to Government-Furnished Equipment (GFE)

An important consideration in FMS procurements is the subject of government-furnished equipment (GFE) that is to be incorporated in a major weapon system or end-item of equipment. An example is aircraft engines. In procuring for its own use, the Department of Defense very often prefers to acquire engines directly from manufacturers and to provide them to airframe producers as GFE. The same may be true for several other

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[1]U. S., Department of Defense, Secretary of Defense, Memorandum for the Secretaries of the Military Departments, Subject: "Sale of Commercially Available Items by the Department of Defense," August 6, 1970, p. 3.

subsystems and components. In making the decision to provide certain items as GFE, the government assumes certain responsibilities that would normally rest with the prime contractor, such as for timely delivery of the GFE, suitability for use, and so forth.

The fact that a weapon system or end item incorporates one or more pieces of GFE may be the major determinant of the export channel that is chosen to complete the sale. According to the Military Assistance and Sales Manual:

> Since the U. S. Government is not authorized to sell military equipment to private parties, such GFE can only be sold to foreign governments or international organizations. This GFE likewise cannot be sold to U. S. prime manufacturers for incorporation in weapon systems and onward sale to foreign buyers. Our practice, therefore, is to use the FMS channel.[1]

Whether the GFE constitutes a major or minor portion of the end item, direct commercial sale of the end item is precluded.

Government property can only be disposed of as specifically authorized by law. At present, GFE cannot be sold to private parties by the government; however, there is no prohibition against a prime contractor for an end item buying components (that would normally be provided as GFE) direct from the manufacturer of the components. Although such an arrangement could facilitate a direct commercial sale of the end item to a foreign government, there are a number of factors that generally inhibit this method. For example, the number of different GFE items and manufacturers that may be involved, the prices of the

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[1]Military Assistance and Sales Manual, Part III, p. D-3.

items, or their nonavailability when needed may effectively foreclose use of the commercial sale channel. Under these circumstances, and assuming that the sale is otherwise approved, the government provides the GFE to the prime contractor, and the end item with the GFE installed is sold through the FMS channel.

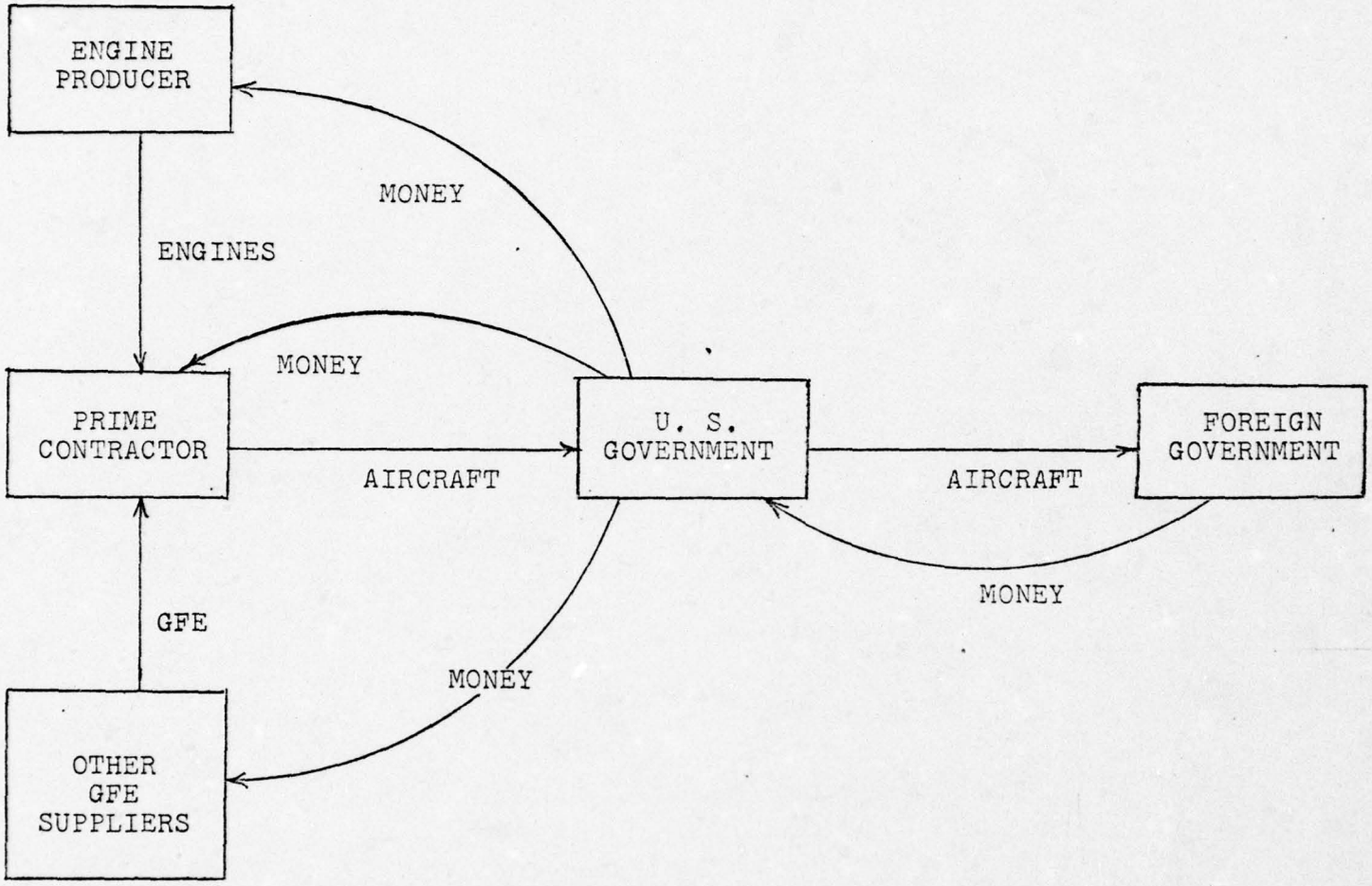
An alternate channel has been employed in some instances which results in a portion of the sale being consummated on a commercial basis. Some sales of a current-production Air Force aircraft have been of the dual-channel type. In these situations, the airframe has been sold commercially, while GFE, spare parts, support equipment, management services, and the like have been sold through the FMS channel. The commercial portion of the transaction is covered by a contract between the contractor and the foreign government which is subject to the normal export licensing requirements of the Department of State. The GFE and related items and services are covered by a letter of offer between the two governments and by a contract between the U. S. Government and the contractor. Figure 2 illustrates the transaction process for a typical foreign military sale, while Figure 3 portrays the combined commercial sale/FMS transaction.

Although the mixed-channel mode of transfer does result in a greater volume of commercial sales than would be the case if the entire sale were made through the FMS channel, there are some problems created by the combined sale. For example, communication and coordination are more complex. While the

FIGURE 2

TRANSACTION PROCESS FOR

FOREIGN MILITARY SALES (FMS)

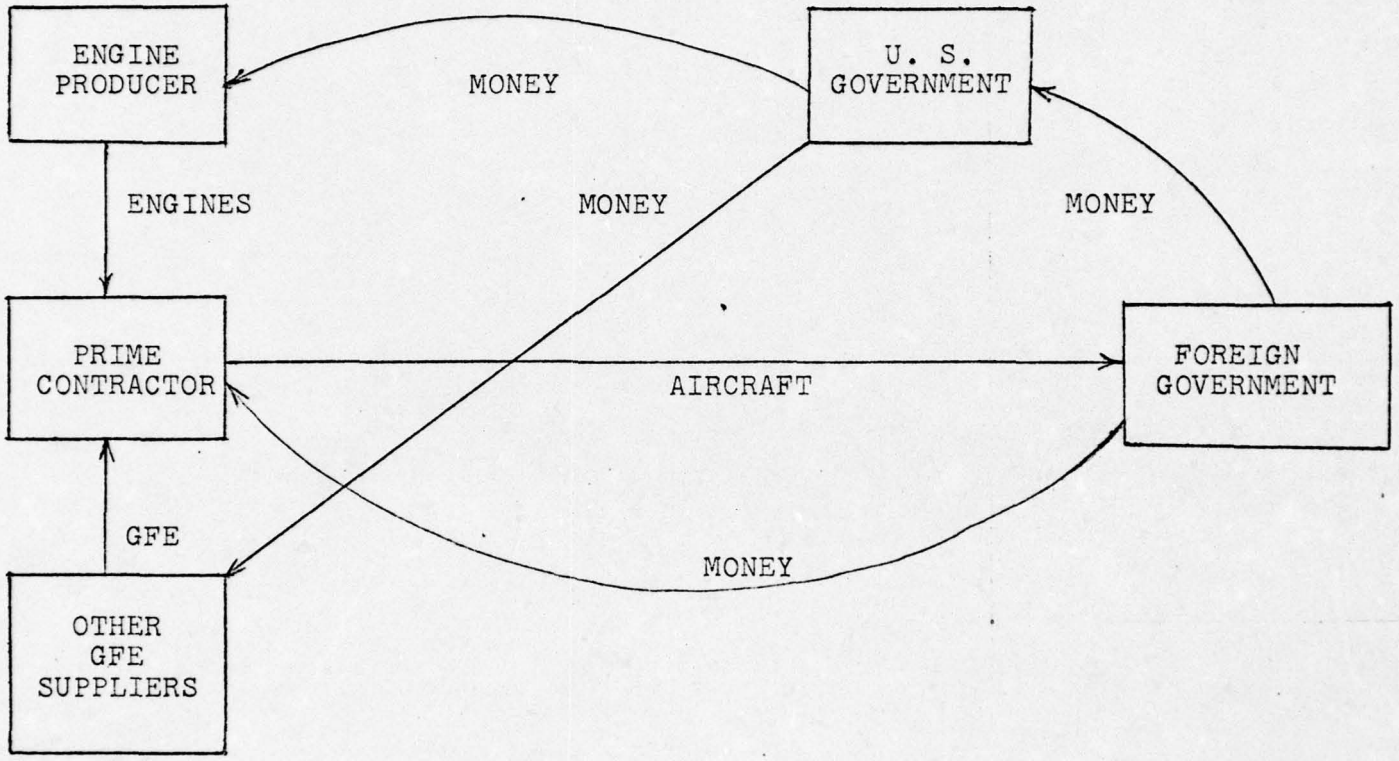


Source: Lt. Colonel Howard Zaner, Headquarters, Air Force Systems Command, Briefing: "Foreign Military Sales."

FIGURE 3

TRANSACTION PROCESS FOR COMMERCIAL SALE/FMS

(Airframe Sold Commercial; Engines and Other GFE Sold FMS)



Source: Lt. Colonel Howard Zaner, Headquarters, Air Force Systems Command, Briefing, "Foreign Military Sales."

contractor for the end item is finalizing the direct commercial sale, the government must insure that timely action is taken to secure and deliver long-lead time GFE items. In addition, the pricing and availability study and the letter of offer covering GFE and related items and services may have to take into consideration certain costs that would normally be associated with the airframe portion of the FMS, such as nonrecurring research and development cost recovery and reimbursement for contract administration services.

Another variation concerning the provision of GFE to support an end item of equipment was reported by one respondent. To facilitate a commercial sale of the end item, the GFE was furnished through the FMS channel. However, in this instance, the GFE was sold to the manufacturer of the end item on the basis that the company had been designated by the foreign government to act as its legal agent. The military department inserted special provisions in the agreement to the effect that the responsibility of the department ended upon delivery of the GFE to the contractor. Installation of the GFE, suitability for use with the end item, and delivery of the end item were clearly made the responsibilities of the contractor.

The preceding discussion illustrates the importance of GFE as a determinant of the channel selected to carry out a particular sales transaction. Attempts are sometimes made to treat a major portion of the sale as a commercial transaction by transferring the GFE through the FMS channel, either to the foreign government or to the end-item manufacturer acting as

an agent for the foreign government. As noted, these mixed-channel sales create problems in coordination, cost recovery, and in delineating the responsibilities of the foreign government, the U. S. Government and the contractor.

Implementing Offset Procurement Agreements

An area that is receiving increased attention is the demand by more foreign governments to tie offset or reciprocal procurement arrangements to foreign military sales made in the U. S. The term offset refers to, "the offering on a selective basis, to foreign governments of opportunities to respond to selected DOD procurement requirements."[1] At present, the DOD prefers that offset arrangements not be made a part of FMS agreements. Some of the problems and constraints associated with DOD involvement in offsets are the following:[2]

1. Foreign sources have difficulty competing against U. S. sources for specific requirements, thus making fulfillment of offsets uncertain

2. The DOD program to maintain a U. S. mobilization base of producers eliminates many items from foreign bidding

3. Assuring proper quality of foreign-produced items is difficult

4. Waivers to the Buy American Act and DOD gold flow

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[1]Military Assistance and Sales Manual, Part III, p. D-7.

[2]Ibid., p. D-8.

rules may be necessary in order to accept foreign bids[1]

5. There are pressures from political and industrial groups to resist foreign competition

An example of the latter factor is the Aerospace Industries Association's view of offset purchases:

> Perhaps the most important development has been the impact of foreign competition and foreign government demands for offset procurement. The intensity of competition (often subsidized by foreign governments) in the international market for military products requires FMS procedures which will expedite transactions on behalf of the contractor rather than procedures designed to protect the interests of the foreign buyers.[2]

It is understandable that the industry view of the effectiveness of foreign competition is somewhat different from the DOD view.

Nevertheless, it is evident that foreign governments, particularly the industrialized nations of Western Europe, are increasingly demanding reciprocal arrangements when making FMS procurements in the U. S. For example, the recently-concluded sale of the F-16 fighter aircraft to the NATO consortium was reportedly made possible through offset agreements which will permit the cooperating nations to recoup a major

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[1]The Buy American Act of 1933 (41 U.S.C. 10a-d) established a government-wide procurement policy to restrict contract awards for foreign articles, materials and supplies. Within the DOD, the Act is implemented through the ASPR gold flow rule which applies a fifty percent price differential factor in evaluating items of foreign origin. Executive Order 10582 provides that an item is of foreign origin if the cost of foreign components exceeds fifty percent of the total cost.

[2]Karl G. Harr, Jr., Aerospace Industries Association of America, Inc., to William G. Clements, Jr., Deputy Secretary of Defense, November 1, 1974, p. 2.

portion of the program cost through the manufacture of parts for the F-16 as well as through the opportunity to compete for other DOD procurements.[1]

In the past, the DOD has executed offset agreements with the United Kingdom, the Federal Republic of Germany, Italy, Norway, Australia, and Belgium, many of which remain in effect (1975). Typical arrangements call for the U. S. to offset between fifteen and thirty percent of particular foreign military sales by reciprocal purchases from the foreign nation. The length of time that such offset agreements remain effective ranges from five years to an indefinite period of time.

The implementation of offset purchase arrangements becomes a matter of concern with respect to policies and procedures governing FMS procurements because of the manner in which the DOD prefers that such offset agreements be fulfilled. According to DOD policy, "it is the responsibility of the U. S. company or companies and their subcontractors involved in producing the equipment who would thereby benefit from the sale (i.e., the FMS sale) to undertake offset procurement from the buying country."[2] At the present time, the ASPR contains no policy or procedural guidance relative to implementing offset arrangements under FMS procurements.

If the DOD is convinced that the offset agreement cannot

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[1]Erwin J. Bulban, "U. S. Sets Fighter Sale Price to NATO," Aviation Week and Space Technology, February 24, 1975, pp. 14-15.

[2]Military Assistance and Sales Manual, Part III, p. D-8.

be fulfilled by the contractor for the FMS procurement, the Department may choose to permit sources in the foreign country to compete for selected DOD requirements. If so, Buy American or gold flow price differentials will not be applied in evaluating the foreign bids. The order of preference for fulfilling offset agreements under such circumstances is as follows:[1]

1. Items of government-furnished equipment provided to the contractor involved in the FMS procurement

2. Items of equipment in the same general industrial category as the item being sold through FMS

3. Items funded from non-appropriated funds

4. Items not directly related to the equipment being sold through FMS

Regardless of the type of defense requirement offered for foreign competition, the DOD insists that: (1) the foreign source be fully responsive to performance, quality and delivery requirements, and (2) the price not exceed that offered for comparable U. S. items eligible for award.

In 1974, the DOD performed an internal audit to examine existing offset arrangements and the manner in which they had been implemented for the purpose of identifying deficiencies in the management of such activities. The review disclosed that the responsibility for implementing offset arrangements had not been properly assigned, that a reporting system to provide necessary management data had not been established,

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[1]Ibid.

and that criteria for determining which DOD procurements would be creditable against offset arrangements had not been adequately defined. As a result of the findings, it was recommended that the DOD:[1]

1. Develop policies and procedures for the implementation of future offset arrangements

2. Develop a complete and standard system for identifying, recording, and reporting purchases under offset arrangements

3. Establish specific criteria for identifying all procurements eligible for offset against DOD targets

In light of the absence of ASPR coverage, the first two recommendations cited above are particularly pertinent.[2] In those situations when the contractor for the FMS procurement is to fulfill the offset arrangement in total, there is a need for a contract provision to specify the contractor's responsibilities. The clause should address areas such as the value of offset procurement to be achieved, the duration of the arrangement, any special conditions relating to the evaluation of foreign bids, and a requirement for the contractor to periodically report to the DOD his progress in implementing

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[1]U. S., Department of Defense, Deputy Assistant Secretary of Defense (Audit), Report on Review of the Implementation of Foreign Military Sale Offset Arrangements, Report No. 599, May 29, 1974, p. 3.

[2]Proposed policies and procedures to implement offset arrangements have been drafted by the Office of the Assistant Secretary of Defense (Installations and Logistics), revised by an ASPR subcommittee, and submitted to the ASPR Committee for consideration.

the offset arrangement. A Buy American waiver for the offset procurements would not normally be required when the offset is being fulfilled under the FMS since the Act does not apply to items purchased for use outside the United States.[1]

When the DOD determines that an offset procurement arrangement will extend beyond the instant FMS, a notice should be placed in eligible solicitations to the effect that bids from sources within the particular foreign country will be considered for award. Under such circumstances, the DOD would agree to evaluate the foreign bids without application of Buy American or gold flow differentials and to waive these restrictions if the foreign bid is low and otherwise acceptable considering quality, proposed delivery, and other appropriate factors.

Although the development of policies and procedures for the implementation of offset arrangements under FMS procurements appears relatively straightforward, respondents suggest that several factors will combine to make offset arrangements difficult to achieve in the future.

1. Notwithstanding the offset target (normally expressed as a percentage of the FMS procurement or as a specific dollar value), the ability of foreign sources to compete effectively against U. S. sources is the prime determinant in fulfilling the offset agreement. For example, if the foreign sources are attempting to compete as subcontractors under an FMS procurement for a small quantity of an established weapon system end item,

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[1]ASPR 6-103.1.

it is likely that their U. S. counterparts are already operating "down the learning curve" in terms of experience in producing the sub-item.

2. If the DOD decides to select certain defense requirements for foreign competition in order to assist in fulfilling offset arrangements, there are likely to be pressures from domestic contractors who would not directly benefit from the FMS procurement and yet would face foreign competition brought about by the sale to the foreign government. Several examples of such reciprocal purchases are being discussed under the F-16 offset agreements mentioned previously.[1]

3. On the other hand, even though the offset targets are normally not considered to be firm commitments to make U. S. purchases abroad, failure to fulfill such arrangements could jeopardize future foreign military sales to the countries involved.

To the extent that offset arrangements are in consonance with the economic principle of comparative advantage, such agreements should facilitate defense procurement by both parties.

Areas of Concern in the Selection and Award Phase

In the selection and award phase, problems are identified under the following headings: (1) pricing to recover full costs, (2) payment of agent's fees, (3) special profit consideration for FMS, (4) financing arrangements under FMS contracts,

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[1]"Buying Guns to Sell Planes," Business Week, June 23, 1975, p. 51.

and (5) exercising options for the benefit of FMS requirements.

Pricing FMS to Achieve Full Cost Recovery

One of the criteria of performance for FMS which was discussed in Chapter III specifies that such sales for the benefit of foreign customers are to be conducted at no loss to the U. S. Government. More specifically, the following statutory requirements are pertinent:[1]

1. Cash sales from the stocks of the Department of Defense can be made to foreign governments at not less than the value thereof

2. Procurement for cash sales must be accompanied by an agreement specifying that the foreign customer will pay the full amount of the contract assuring the U. S. Government against any loss

3. Procurement for credit sales is authorized provided the customer agrees to repay not less than the value of the goods including interest

A discussion of the degree to which under-recoupment of cost or subsidization of FMS by the DOD has been a problem depends in part on what constitutes "cost" and "value." In examining cost recovery in procurements for FMS (as opposed to sales from DOD stocks), there are several elements that must be examined.

First, perhaps the most clear-cut item is the contract price which is a funded cost that must be fully borne by the

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[1]The Foreign Military Sales Act of 1968, secs. 21-23; 22 U.S.C., secs. 2761-63.

foreign customer. Existing policy and procedural guidance are adequate in addressing this element of cost in FMS procurements.

Second, there is the unfunded category which deals with recurring support costs incurred by the U. S. Government including items such as government-provided services, transportation and administration. Although the policy and procedural guidance pertaining to this element are relatively clear, the adequacy of recoupment is subject to question.

A third category has to do with sunk investment costs expended by DOD such as nonrecurring research, development and production costs. Also included are the costs associated with government-owned and operated facilities such as arsenals and repair depots; government-owned, contractor-operated facilities such as many of the Army's ammunition plants; and government property used in contractor-owned, contractor-operated facilities. Policies and procedures regarding investment cost recoupment are less explicit and more subject to variations in interpretation.

There is evidence that the second and third categories of cost--recurring support costs and sunk investment costs--have not been fully recouped in recent years. Such evidence has been gathered through audits conducted by the U. S. General Accounting Office (GAO), Department of Defense internal audits, and informal DOD studies.

One recent GAO report examined foreign military sales made to the Government of Iran, presently the largest foreign

customer for U. S. military equipment.[1] The report concluded that administrative costs of $10.5 million had not been recovered and that concessionary interest rates granted on FMS credit sales during 1965 through 1969 had resulted in unrecovered costs of over $24 million.

In a series of audits conducted during the period 1972-1974, the GAO found that the cost of government-owned plant and equipment was not being fully recovered on foreign military sales. Specifically, the following costs were involved:[2]

1. Depreciation of plant and equipment and other unfunded costs at defense industrial activities such as arsenals and depots

2. Charges for the use of plant and equipment at government-owned, contractor-operated facilities producing weapons for FMS, such as Army ammunition plants

3. Charges for the use of government-owned plant and equipment by contractors producing items for FMS

A DOD internal audit report issued in June 1974 confirmed the GAO findings and noted that approximately $3.6 million in unfunded costs had not been recovered during FY 1973

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[1]U. S., General Accounting Office, Issues Related to U. S. Military Sales and Assistance to Iran, B-133258, October 21, 1974, p. iii. (Unclassified digest of the report)

[2]U. S., General Accounting Office, Action Needed to Recover Costs of Government-Owned Plant and Equipment for Foreign Military Sales, B-174901, September 7, 1972; April 9, 1973; October 7, 1974.

and FY 1974 by the defense industrial activities included in the sample.[1] No estimate was given of the unrecouped costs associated with contractor use of government-owned property for FMS orders.

Finally, an informal DOD study of one major weapon system that has been sold through the FMS channel for a number of years estimated that only about twenty-five percent of the nonrecurring research, development and production costs and recurring support costs were being recouped. Although the informal study does not purport to be representative of all major weapon system programs, it does tend to support the findings cited in the previous paragraphs.

With respect to the problems associated with the non-recovery of costs in the categories mentioned, it is appropriate to examine the extent to which DOD policies and procedures may have contributed to the under-recoupment.

First, with regard to the mandate to recover the full contract cost, the ASPR and the terms and conditions of the Letter of Offer and Acceptance make it clear that such costs are to be fully recouped.

Second, policy statements specify that administrative costs are to be recouped through the application of a two percent surcharge to the sale price reflected in the letter of

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[1]U. S., Department of Defense, Deputy Assistant Secretary of Defense (Audit), Report on Review of DOD Practices for Recovering Costs of Producing Weapons Sold to Foreign Governments, Report No. 504, June 17, 1974.

offer.[1] Procedures specify that the surcharge rate will be validated at least every two years and that the military departments may apply actual charges if different from the surcharge amount. Shortcomings in this area would appear to be associated with identifying and reporting the costs subject to recoupment on individual cases rather than with the policies and procedures governing the application of the administrative surcharge.

Third, the category of sunk investment costs is less specifically addressed in the ASPR and related DOD guidance:

1. Although the DOD directive dealing with recovery of nonrecurring research, development and production costs was revised in early 1974, the ASPR has not yet been updated to reflect the expanded policy guidance.[2] Nevertheless, the procedures cited in the directive for calculating amounts to be recouped and for waiving recoupment are subject to interpretation and are apparently not uniformly applied.

2. Policy statements governing recovery of costs for the use of government-owned plant and equipment have been vague and even contradictory in some instances:[3]

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[1]U. S., Department of Defense, Assistant Secretary of Defense (Comptroller), Pricing of Sales of Defense Articles and Services to Foreign Countries and International Organizations, Instruction No. 2140.1, January 29, 1970, as amended July 17, 1973, p. 10.

[2]U. S., Department of Defense, Assistant Secretary of Defense (Comptroller), Recovery of Nonrecurring Costs Applicable to Foreign Military Sales (FMS), Directive No. 2140.2, January 23, 1974.

[3]Idem, Pricing of Sales of Defense Articles, p. 16.

a) Since 1968, it has been DOD policy to recoup depreciation on plant and equipment in defense industrial activities used for the benefit of FMS customers, but inadequate procedural implementation contributed to the under-recoupment cited earlier

b) A policy to charge for the use of government-owned plant and equipment in producing goods for FMS at government-owned, contractor-operated facilities was established in 1973; however, procedural guidance was not included in the directive

c) The policy of DOD with respect to the use of government-owned property in contractor-owned and operated facilities for the benefit of FMS customers remains contradictory, i.e., one part of the ASPR (paragraph 4-109) states that such costs will be recouped, while another part of ASPR (paragraph 13-406) provides that rent-free use of government property may be granted to encourage foreign sales

The rent-free use policy is difficult to justify on economic grounds. The basic policy of the government with respect to furnishing production and research property to contractors is to restrict such authorization to cases that are clearly advantageous to the government. It is preferred that each contractor provide his own plant and equipment in total. When rent-free use of government-owned production and research property for the benefit of FMS was first authorized in the 1960s, the intent was to improve the U. S. balance of payments position and to increase the competitiveness of U. S. industry in world markets. However, the incentives are structured in

such a manner that a contractor possessing a greater proportion of government-owned property may receive the larger subsidy to facilitate a foreign military sale. In other words, a producer who provides all his own plant and equipment would be penalized in competing against a manufacturer who is granted rent-free use of government property. Even though the ASPR states that no competitive advantage is to accrue by virtue of rent-free use of government property, the potential for such advantage is present.[1]

In summary, it has been demonstrated that pricing of FMS to achieve full cost recovery has been a problem area in recent years, particularly with regard to the category of sunk investment costs. The defense policies and procedures that have contributed to the under-recoupment include the following: (1) the policy concerning rent-free use of government-owned property for the benefit of foreign sales appears to contradict both the statutory requirements cited earlier and the DOD policy regarding recoupment of nonrecurring research, development and production costs, (2) the latter policy inadequately provides for how such recoupments are to be calculated and applied, and (3) the authority to waive recoupment of nonrecurring costs is granted subject to ill-defined criteria, i.e., when in the interests of the U. S.

The trends noted in Chapter III toward increased sales of current-production weapon systems and sales involving research

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[1]ASPR 13-401.

and development efforts hasten the need for clear and consistent policy and procedural guidance regarding the manner in which full cost recovery is to be accomplished in conducting FMS procurements for the benefit of foreign governments. To quote the GAO, "to the extent that U. S. costs are not recovered, they become a form of invisible grant aid."[1]

Allowability of Agent's Fees in FMS Procurements

A persistent problem associated with FMS procurements that has been exacerbated by the increased volume of FMS, in particular on large individual sales, is the question of agent's fees or commissions. Such fees have long been considered to be an allowable cost element on normal DOD procurements--provided payment is made to a bona fide employee or established selling agency retained by the contractor. In developing unique regulatory guidance for FMS procurements, agent's fees were also determined to be necessary costs of doing business with a foreign government; however, several problems have arisen in recent years concerning the payment of such fees in connection with FMS procurements.

1. Foreign military sales are made in over ninety nations in every part of the world. There is a wide variance in the customs of these countries and in accepted methods of transacting business. The long-standing rules that have been applied in normal defense procurements to substantiate the existence of an established domestic agency relationship have

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[1]U. S., GAO, Issues Related to U. S. Military Sales, p. iii.

proven more difficult to apply with respect to many foreign locations.

2. Separating legitimate agent's fees from questionable payments also poses a difficult problem. Recent testimony before the Senate Subcommittee on Multinational Corporations of the Committee on Foreign Relations has highlighted the difficulty of making such judgments.[1] In addition, a report prepared by Ashok Kapoor and J. J. Boddewyn indicates that the problem is not restricted to FMS transactions. Their study of government-business relations overseas cites the sporadic or regular use of many types of intermediaries by multinational enterprises including, "expediters, lobbyists, door openers, and advisors--usually individuals with good connections based on social status and/or political or bureaucratic experience."[2] These intermediaries are employed in securing the enterprise's share of "scarce goods" controlled by the local government such as permits, subsidies, legal actions, and the like.

3. The application of a small percentage commission rate may result in a very large fee. While a small rate applied to a small sale results in a fee that can be readily evaluated in light of the efforts expended by the agent, a very large fee resulting from the application of the same small percentage commission rate to a substantial sale makes the determination

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[1]"Congress will Probe Foreign Bribes," Business Week, May 26, 1975, p. 36.

[2]Ashok Kapoor and J. J. Boddewyn, International Business-Government Relations: U. S. Corporate Experience in Asia and Western Europe (New York: AMACOM, 1973), p. 62.

of reasonableness of the fee much more difficult.

4. While the U. S. Government contracting officer has been charged with the responsibility for determining the reasonableness of agent's fees on FMS contracts, there have been few precedents and tools placed at his disposal to assist in rendering such a judgment.[1] There have been almost no foreign military sales or commercial arms sales in the past to match the magnitude of more recent sales in those areas of the world where agent's fees have been most common, particularly in the Middle East and Latin America. In commenting on the supplementary guidance placed in the ASPR in 1973 for the purpose of aiding the determination of reasonableness of agent's fees, an Air Force ad hoc study questioned the requirement for comparison of proposed fees with: (1) commercial practices, (2) the extent of services rendered, or (3) a cost breakdown of the fees, while ignoring whether or not the agent was instrumental in concluding the sale on behalf of the contractor.[2] These comments are indicative of the wide range of issues identified by respondents in connection with the determination of reasonableness of agent's fees.

5. Certain foreign governments in addition to Iran are attempting to limit agent's fees on FMS procurements to those cases when specific advance approval of inclusion of the fee

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[1]The guidelines governing the determination of reasonableness of agent's fees are discussed in Chapter IV.

[2]Security Assistance Impact Study, Panel D, Task G, p. 3.

has been granted by the foreign government. A Defense Security Assistance Agency spokesman notes that a principal reason for the use of the FMS channel in arms sales to the Middle East is to "eliminate the influence factor in equipment selection as well as to restrict the payment of exorbitant fees to a local agent on major procurements."[1]

The problem of agent's fees in FMS procurements can be summarized briefly. There is a need to continue to recognize a legitimate element of cost that has been recognized in the past. The difficulty lies in developing and conveying a methodology for making the necessary determinations concerning allowability and reasonableness of such fees under widely varying conditions of custom and practice.

Special Profit Consideration for FMS Procurements

As described in the preceding chapter, a special profit factor for FMS procurements is provided for in the ASPR. This special profit consideration is over and above any profit objective that would be associated with a comparable DOD procurement. Discussions with respondents indicate certain difficulties in interpretation of the ASPR guidance and non-uniformity in the application of the special profit factor. In particular, problem areas include: (1) overlapping coverage relating to recognizing costs of doing business with a foreign government and to the special profit factor, (2) determining

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[1]U. S., Department of Defense, Defense Security Assistance Agency, "Agent's Fees in the Middle East," unpublished article, July 5, 1974, p. 6.

applicability of the special profit consideration to specific procurements, and (3) deciding the size of the special profit factor to allow.

A brief review of the method used to determine the profit percentage objective on normal DOD procurements provides insight as to the meaning of the special profit factor for FMS and its application. The ASPR provides that:

> For each contract in which profit is negotiated as a separate element of the contract price, the aim of negotiation should be to employ the profit motive so as to impel effective contract performance by which overall costs are economically controlled. To this end, the profit objective must be fitted to the circumstances of the particular procurement, giving due weight to each of the performance, risk, and other factors set forth in this [regulation].[1]

Major weapon system purchases normally result in negotiated procurements priced on the basis of cost analysis, and the ASPR provides that the weighted guidelines method will be employed to establish a profit objective for contract negotiation.

The weighted guidelines method requires that the contracting officer give consideration to the following elements in arriving at a profit objective to use in negotiations:

1. Contractor's input to total performance
2. Contractor's assumption of contract cost risk
3. Record of contractor's performance
4. Selected profit factors
5. Special profit consideration

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[1]ASPR 3-808.1(a).

Under each category are factors which are assigned weights within a specified range. The contracting officer must assign a weight appropriate to the circumstances for each factor in order to arrive at a profit percentage objective. For example, the contractor's record of performance carries a weight range of -2 to +2 percent based on factors such as cost efficiency, timeliness of deliveries, quality of product, and so forth. It is likely that the negotiated profit will vary from the profit objective and that the profit earned during performance will differ from the negotiated profit. Nevertheless, the weighted guidelines method must be employed in all negotiated contracts requiring cost analysis.

As stated previously, the ASPR establishes a special profit consideration for FMS procurements ranging from one to four percent of recognized costs. The criteria for selection of the specific percentage are factors such as: (1) the demonstrable initiative of the contractor in furthering such sales, (2) the responsibility assumed by the contractor for the product after delivery, and (3) other attendant risks.[1]

Another section of the ASPR provides that, in pricing FMS contracts, recognition should be given to costs of doing business with a foreign government such as: (1) selling costs including maintenance of international sales and service organizations, sales commissions, and agent's fees, (2) product support and post-delivery services, and (3) costs of translating

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[1]ASPR 3-808.6(b).

technical manuals and similar materials.[1]

Judging from the findings of an Air Force study and statements by respondents in each of the military departments, the interpretation of the related ASPR provisions cited above results in non-uniform applications of FMS cost and profit factors.[2] For example, selling costs attributable to international marketing are allowed in pricing FMS contracts (to which a normal profit rate would be applied), and special profit consideration is given with regard to the "demonstrable initiative of the contractor in furthering such sales." Some procurement personnel believe that the ASPR treatment results in double recognition of the contractor's sales efforts--the costs are recognized and allowed and an additional profit factor is added. Similarly, costs for product support and post-delivery services are to be allowed on FMS contracts, while the special profit consideration recognizes the responsibility assumed by the contractor for the product after delivery. Again, there appears to be a recognition of costs for providing post-delivery services and a reward for assuming such responsibilities. Some would argue that the intent of the ASPR is not to provide dual recognition.

Another problem area concerns the types of FMS

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[1]ASPR 6-705.3(c).

[2]U. S., Department of the Air Force, Deputy Chief of Staff, Procurement and Production, Headquarters, Air Force Systems Command, AFSC Comments/Recommendations, Review of ASPR/Other Directives Relating to Foreign Military Sales, December 4, 1973, pp. 9-12.

procurements to which the special profit factor is intended to be applied in recognizing the contractor's efforts. For example the application of a special profit factor in a situation when the U. S. sells items from inventory, and the contractor is subsequently requested to provide support on a contractual basis, is subject to question. The argument against the application of the special profit factor is based on the fact that the contractor's role in the procurement arose from the sale of U. S. inventory and not from any marketing effort on his part. Nevertheless, contractors normally request the special profit consideration on such sales.

On a related basis, contracting officers reported a reluctance to apply the special profit factor to follow-on sales of spare parts even though the original sale may have resulted from the contractor's marketing efforts. Again, their reasoning in support of not allowing special profit is the lack of contractor initiative in making the follow-on sale of spare parts.

A related problem area concerns the interpretation of the ASPR with regard to the one to four percent range of the FMS special profit factor.[1] The regulation calls for the application of judgment in determining the profit factor, but, at the same time, a minimum of one percent additional profit seems to be specified.[2] The Contract Pricing Manual lends some support for those who contend that the contracting officer should have the prerogative of allowing no special profit consideration

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[1]Ibid. [2]ASPR 3-808.6(b).

by providing as follows:

> However the contractor will not qualify for special profit just because he incurs special costs. The special profit is intended to recognize particularly outstanding achievement and to provide a method for creating a profit amount which will permit a contractor to spend monies needed to gain that outstanding achievement which when looked at as cost would not be allowed or recognized in the price. The contractor must convince you he deserves special profit consideration. . . . [1]

In summary, the problem areas associated with profit entitlement on FMS procurements include: (1) differentiating between and clarifying the interpretation of cost factors versus profit factors, (2) specifying the types of procurement actions to which the special profit consideration is intended to apply, and (3) determining the size of the special profit factor to allow under the criteria specified.

Contract Financing Arrangements Under FMS Contracts

Another problem that has arisen in FMS procurements has to do with the contract financing and payment arrangements allowed under such procurements. Again, the problem is aggravated by the large dollar value and lengthy duration of a growing number of FMS contracts. The prevailing practice, in consonance with condition A1 on the reverse of the Letter of Offer and Acceptance which prescribes the use of normal DOD contract clauses for FMS procurements, is to incorporate progress payment provisions in fixed-price-type contracts. Under these

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[1] U. S., Department of Defense, Assistant Secretary of Defense (Installations and Logistics), Contract Pricing Manual, Armed Services Procurement Manual No. 1, February 14, 1969, p. 17-3.

payment terms, the contractor is reimbursed as work progresses on the basis of a percentage (normally eighty percent) of costs incurred. Payments are liquidated as deliveries are made at a rate established in consideration of the profit percentage allowed in negotiation of the contract. Progress payments alone would not provide all of the working capital needed to finance performance of a contract since such payments recognize only a percentage of costs incurred at any given time.[1]

Criticism of the application of progress payment provisions to FMS procurements has been pressed by individual contractors and by one of the major industrial associations.[2] In a letter to the Deputy Secretary of Defense, the Aerospace Industries Association noted that, "DOD contracts for FMS equipment typically provide only the standard eighty percent progress payments, whereas on commercial contracts, the foreign customer is accustomed to making advance payments and milestone-type progress payments which more closely parallel the contractor's expenditures, commitments and progress on the program."[3] The letter requests that DOD give serious consideration to obtaining commercial-type payment terms from its FMS

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[1]ASPR Appendix E sets forth "Defense Contract Financing Regulations" which include policies and procedures governing the use of guaranteed loans, advance payments, and progress payments.

[2]The Aerospace Industries Association of America represents approximately fifty of the leading aerospace manufacturers in the United States.

[3]Karl G. Harr, Jr., Aerospace Industries Association of America, Inc., to William P. Clements, Jr., Deputy Secretary of Defense, November 1, 1974, p. 2.

customers and making them available to defense contractors. The result in most cases would be an improved cash flow position for the contractor. In essence, the Association is contending that an FMS contract should be treated more as a commercial transaction than as a defense procurement.

A similar recommendation was made to the Office of the Secretary of Defense by the Joint Logistics Commanders.[1] In December 1974, this panel suggested that the DOD develop a procedure whereby down payments and other commercial payment arrangements could be incorporated in FMS contracts by the military departments.

An actual case of the type that triggered the industry criticism is illustrative of the issues involved in analyzing the different financing arrangements. In the particular situation, the contractor was selling an aircraft which was available in both military and commercial versions. Although the commercial version was being sold, the FMS channel was used at the request of the contractor and the foreign government. The U. S. Government accepted the contractor's contention that the item was commercial and priced the contract on the basis of the contractor's established catalog price. In addition, the contractor stated that his standard commercial payment schedule was an integral part of the catalog pricing terms, and thus he requested that the payment schedule be incorporated in

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[1]The Joint Logistics Commanders is a group composed of the Commanders of the Air Force Systems and Air Force Logistics Commands, the Army Materiel Command, and the Naval Material Command. They meet periodically to consider issues of common concern in the logistics area.

the contract in lieu of the normal DOD progress payment provision. The contractor's commercial payment schedule provided for a down payment of five percent of the contract price and milestone payments eighteen-, twelve-, and six months prior to delivery.

Although the government initially agreed to incorporate the commercial payment schedule into the FMS contract, a legal opinion caused the decision to be reversed. In accordance with the military department's standard practice, the FMS procurement was funded with U. S. appropriated funds which were to be subsequently reimbursed by the foreign government under the terms of the letter of offer. Since U. S. funds were to be initially used to pay the contractor, it was determined that commercial-type payments would constitute advance payments and would thus be subject to certain statutory requirements governing such payments. Among other things, the statute requires advance secretarial approval of advance payments, adequate contractor collateral, and notification to Congress if payments are to exceed $25 million. Advance payments differ from progress payments in that the former are not based on or measured against contract performance. When the contractor was advised that such payments could not be made under the circumstances, he contended that the contract price should be increased in recognition of the lesser cash flow generated by the progress payment arrangement as opposed to the commercial payment schedule, and the contractor's interest expense on the difference in cash flow. To resolve the situation, a calculation was made

of the difference in cash flow under the two payment schedules, and the contract profit was increased by a factor to recognize the contractor's greater investment required under the progress payment schedule. Additionally, the normal progress payment provision was incorporated into the FMS contract.

In two reported instances, the Contract Finance Committee (the group under the Assistant Secretary of Defense for Installations and Logistics that must approve deviations from normal contract financing arrangements) has authorized the use of progress payments at a ninety-five percent rate for FMS procurements in lieu of the normal eighty percent rate. The contractor's request was based on the dollar magnitude of the particular programs, the long lead time preceding deliveries under the contracts, and the foreign government's agreement to reimburse the U. S. Government at a rate that would permit the higher progress payments. This method also recognized the contractor's greater investment under the normal progress payment rate. In this case, there was no contention that commercial payment terms should have been authorized.

As a result of cases such as the above, the DOD agreed that the FMS financing issues deserved consideration and assigned the task to the ASPR Committee for review and recommendations.

Exercise of Contract Options for FMS Requirements

As indicated in the preceding chapter, priced option quantities in an existing contract are sometimes used to facilitate the procurement of additional quantities of an item. In recent years, option quantities have been used to directly

fulfill FMS requirements and also to replenish U. S. inventories that were drawn down for the benefit of FMS customers. In 1972, the Comptroller General ruled that options should not be exercised on behalf of FMS requirements unless notice has been given to the contractor. Shortly thereafter, the ASPR was amended to provide that, for purposes of determining whether to exercise an option, a FMS commitment on behalf of a foreign country is considered fulfillment of a need of the U. S. Government.[1] The intent of the revision to ASPR was to give notice that contract options might be exercised on behalf of FMS requirements in the future.

Individual contractors and the Aerospace Industries Association pointed out what they considered to be inequities in the revised ASPR language. Specifically, the industry group has complained that the exercise of production options, originally negotiated to satisfy U. S. needs, for FMS violates "the tradition of noncompetition between U. S. Government inventories and U. S. industry," and "is a prime example of the use of U. S. Government bargaining power to the advantage of a foreign buyer [and] to the detriment of a U. S. contractor."[2] In addition, economic developments subsequent to the granting of the option may have made the arrangement unprofitable to the contractor.

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[1]ASPR 1-1505(c)(ii).

[2]Karl G. Harr, Jr., Aerospace Industries Association of America, Inc., to William P. Clements, Jr., Deputy Secretary of Defense, November 1, 1974, p. 3.

The key issue has to do with the fact that the original option price, if negotiated strictly for the purpose of fulfilling U. S. requirements, would not have included any allowance for the FMS cost and profit factors recognized in the ASPR. Therefore, the subsequent exercise of such an option for the benefit of FMS could have the effect of disallowing the FMS cost and profit factors notwithstanding the intent of the intervening ASPR revision to alert contractors to the possible use of options for FMS.[1]

The Military Assistance and Sales Manual does provide additional guidance relative to the exercise of contract options for commercially available items. Option prices in existing contracts are not to be quoted in a letter of offer unless: (1) the option clause in the contract specifically includes quantities for FMS, (2) the original contract included FMS requirements as well as DOD quantities, or (3) the contractor agrees to accept an FMS requirement at the option price, thereby waiving any claim for additional FMS cost or profit factors.[2]

Notwithstanding the above guidance, the present ASPR language with respect to non-commercial items appears to be deficient regarding the contractor's entitlement to additional cost and profit consideration for FMS option quantities in cases when the originally-negotiated option price was for

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[1] Security Assistance Impact Study, Panel D, Task L, p. 1.

[2] Military Assistance and Sales Manual, Part III, p. H-3.

U. S. Government requirements only.

Areas of Concern in the Contract Administration Phase[1]

As indicated in the preceding chapter, condition A1 on the reverse of the Letter of Offer and Acceptance specifies that, in procuring for the foreign government, the DOD shall employ the same contract administration and the same inspection procedures as would be used in a normal DOD procurement unless the parties agree to revise the procedures. The ASPR presently identifies more than fifty functions that are normally delegated to a field contract administration office subsequent to the award of a defense contract.[2] Contract administration normally includes such functions as approving payments to the contractor, providing production surveillance, and performing quality assurance inspections. The ASPR contains no specific instructions as to what contract administration functions are to be performed with respect to FMS contracts; however, the letter of offer states that the "same contract administration and inspection procedures" will be employed.

Nevertheless, an area of concern identified by an Air Force panel has to do with reconciling the extent of contract

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[1]Areas of concern discussed in this section are addressed from the point of view of the procurement activity since the scope of the research did not include visits to field contract administration offices. Consequently, the problem areas identified involve the initial assignment of contract administration functions for FMS procurements, the reimbursement therefor, and a unique deviation from normal contract administration practices.

[2]ASPR 1-406.

administration services provided to the foreign government with the reimbursement for those services.[1] Existing regulations imply that contract administration, as an element of the U. S. logistics system, is to be reimbursed as a portion of the administrative surcharge (presently two percent) added to the letter of offer.[2] However, there is evidence that varying interpretations of the regulations result in full contract administration services being performed on FMS contracts, while only direct quality assurance inspection costs are reported for reimbursement purposes.

As indicated in the preceding section of this chapter, it is clear that the intent of the statute and the implementing regulation is to insure adequate reimbursement for administrative services provided to the foreign government. In fact, the regulation further provides that if the military department determines that the two percent administrative surcharge rate is either insufficient or excessive for any single FMS case, estimated actual costs or actual costs may be used in lieu of the two percent rate.[3] Respondents generally agreed that there is a need to better identify, record, and report appropriate administrative costs for reimbursement.

One respondent reported a unique deviation from normal

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[1]Security Assistance Impact Study, Panel D, Task P, pp. 1-2.

[2]U. S., DOD, Pricing of Sales of Defense Articles, p. 9.

[3]Ibid., p. 10.

contract administration practice they may warrant further investigation and guidance in the ASPR and appropriate DOD directives. In some instances, the foreign government has appointed a representative of a U. S. Government field contract administration office to act as the country's legal agent for the purpose of accepting goods and services under the FMS procurement. In other words, the U. S. Government representative accepts delivery from the contractor under the contract (a normal practice), and the U. S. Government representative, acting as the foreign government's agent, accepts delivery from the U. S. Government under the letter of offer (an unusual deviation). Certain aspects of the arrangement pointed out by the respondent may be legally objectionable:

1. The concept of the U. S. Government acting in the dual capacity as both seller and agent for the buyer

2. The question as to whether the U. S. Government representative should be required to register with the Department of State as an agent of a foreign government

3. If the U. S. Government representative is a military officer, the question as to the legality of such a relationship under the Constitution

Whether or not such an arrangement is held to be a valid one, since the practice is in existence, guidance should be provided in the ASPR and appropriate DOD directives.

Summary

This chapter identified and analyzed problem areas associated with FMS procurements utilizing the framework of the defense procurement process--exogenous factors, planning, source solicitation, selection and award, and contract administration.

Funding and needs determination were viewed as exogenous factors; however, certain aspects were found to have a direct bearing on procurement policies and procedures related to FMS procurements. Funding of FMS procurements is not now standardized. Some procurement activities cite foreign trust funds directly on contracts while others cite U. S. appropriated funds which are subsequently reimbursed by the customer. Although both approaches are authorized, DOD is considering standardization of FMS funding. From a procurement standpoint, the legal implications of each approach need to be scrutinized, particularly with regard to the effect on certain statutory and regulatory provisions now applied to FMS contracts, such as renegotiation and other socio-economic requirements. Needs determination by the foreign government creates certain problems for the procurement process. For example, requests for purchase are received "out of cycle," and many letters of offer are never accepted by the requester. In addition, consolidation of requirements or use of flexible contracting techniques may not be feasible.

With regard to the planning phase, procurement problems associated with the pricing and availability study and the letter

of offer were examined. In the preparation of the pricing and availability study, the limited involvement of the procurement organization and the contractor is a matter of concern which is aggravated by the tight time constraints under which such studies are prepared. In addition, there is pressure to provide a price for the letter of offer which will not require upward adjustment subsequent to acceptance. The letter of offer sometimes fails to communicate essential features of the agreement. For example, a sole-source designation may not be specified even though the customer intended to do so, supporting equipment or services required in conjunction with a particular system may not be indicated, and procedural variations agreed to may not be communicated to procurement personnel.

Under source solicitation, problems were identified in three areas--clarifying the definition of commercial availability relative to FMS, resolving issues related to government-furnished equipment (GFE), and effecting the implementation of offset purchase arrangements. Even though Congress has indicated that DOD should return the maximum amount of FMS to direct commercial channels, pertinent DOD directives have not yet addressed how the definition of commercial availability should be modified. The presence of GFE components in an end item may dictate use of the FMS channel, since GFE cannot be sold by the government to private parties. In some instances, commercial sales have been facilitated by use of a mixed-channel transaction with the GFE being sold to the foreign government through the FMS channel. This approach creates

problems in coordination, cost recovery and determining responsibility for GFE. Offset purchase arrangements are increasingly being requested in conjunction with FMS being made to industrialized nations. DOD prefers that such offsets be fulfilled by the contractor benefiting from the FMS. Contractual provisions to spell out the contractor's responsibility with respect to reciprocal purchases are needed. In addition, when DOD determines that foreign sources may be solicited for other defense requirements under offset agreements, solicitation notices should specify bid evaluation procedures applicable to the foreign responses.

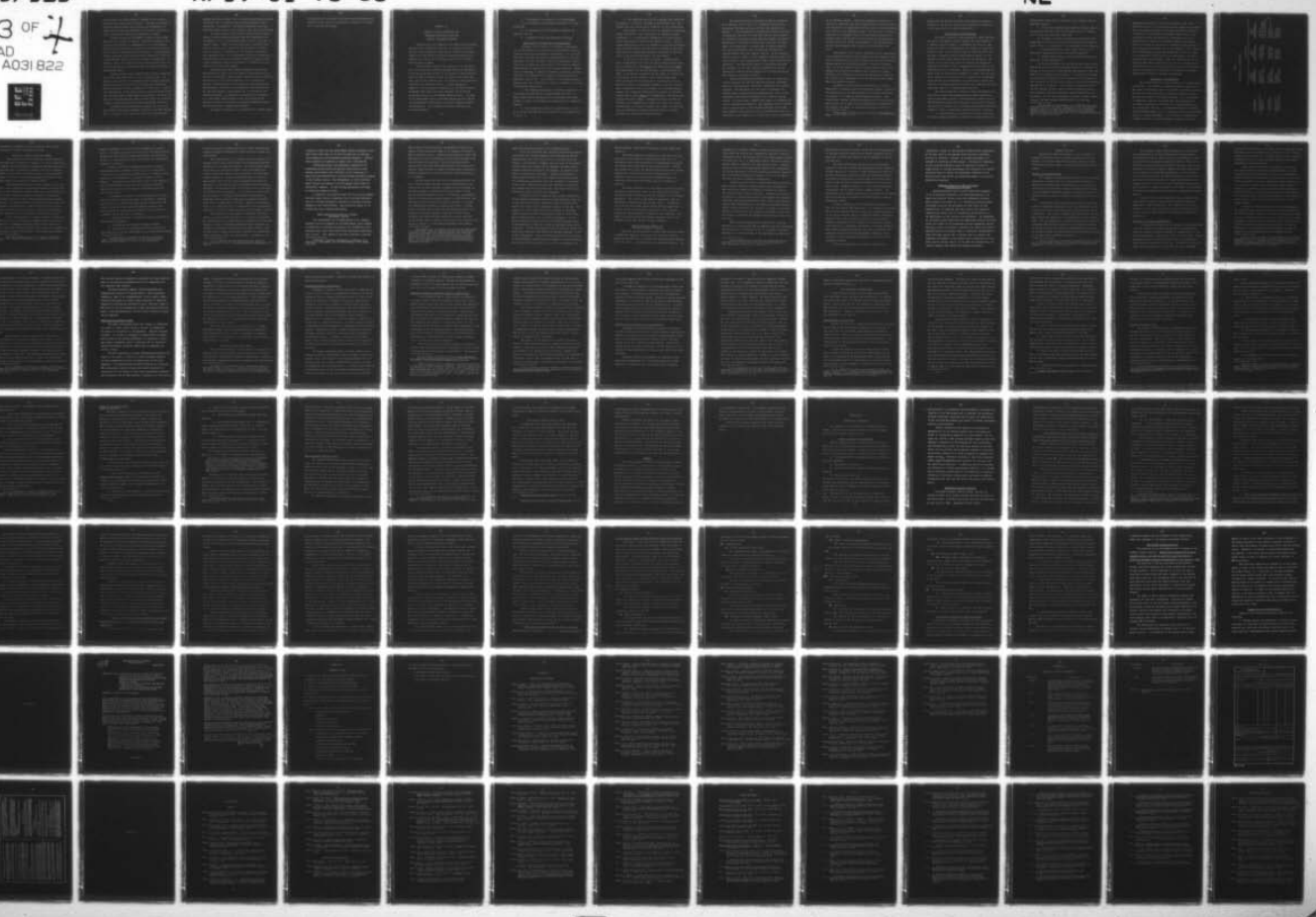
In the selection and award phase, problems were identified under the following headings: (1) pricing to recover full costs, (2) payment of agent's fees, (3) special profit consideration for FMS, (4) financing arrangements under FMS contracts, and (5) exercising options for FMS.

The issue of pricing to recover full costs extends beyond the procurement functional area since several cost categories such as accessorial and administrative charges are recouped through surcharges applied to the letter of offer; however, the recoupment of investment costs including nonrecurring research, development and production outlays is a matter of concern with respect to procurement policies and procedures. Specifically, the conflicting policies dealing with recoupment of research, development and production costs and with rent-free use of government-owned production and research property for FMS need to be reconciled. It would appear that

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the rent-free use policy operates contrary to the intent of the statutory cost-recovery criterion. Although recoupment of recurring administrative costs seems to be inadequately accomplished, the problem stems from the incomplete identification, recording and reporting of appropriate charges.

Several aspects of the payment of agent's fees on FMS contracts are a matter of concern. Procurement personnel have experienced frustration in applying tests of reasonableness and allowability developed for domestic situations to agent's fees in widely differing foreign environments. Distinguishing between legitimate fees and questionable payments is difficult in both FMS and other international commerce transactions. In addition, small percentage rates which have been acceptable in the past may result in exorbitant fees when applied to large dollar-value sales.

Several problems have surfaced with respect to applying the special FMS profit factor of one to four percent. For example, the existence of overlapping ASPR language regarding FMS marketing costs and profit in recognition of marketing efforts may result in dual recognition in some cases. Further, the applicability of the profit factor to sales from DOD stocks and follow-on sales of spare parts is questioned. Finally, the ASPR criteria governing the special profit factor are difficult to apply in deriving a specific profit percentage objective.

A problem raised primarily by industry has to do with the contract financing arrangement specified in an FMS procurement. Contractors have complained that normal DOD progress

payment provisions require them to furnish proportionally greater investment than if commercial-type milestone payments were authorized. Consequently, contractors generally desire more favorable payment terms on FMS contracts than are now authorized.

In determining whether contract options should be exercised, the ASPR presently provides that FMS requirements are considered to be U. S. Government needs; however, two areas of concern remain. First, the contractor must be notified that contract options may be exercised for the benefit of FMS if such is the case. In addition, if the original option price was established for U. S. requirements and did not include any consideration of FMS cost and profit factors, it appears that a price adjustment would be authorized if the option is to be exercised to fulfill FMS demands.

Although unique ASPR coverage regarding contract administration for FMS is not in evidence, certain areas of concern were identified. Since contract administration is normally performed by a field office cognizant of the contractor's facility, uniform procedures are needed for assigning contract administration functions to be performed on FMS contracts and for insuring adequate reimbursement for the services by the foreign government. In addition, the practice of allowing a U. S. Government representative to act as an agent of the foreign government for purposes of accepting deliveries under FMS contracts may be legally objectionable.

The report now turns to a consideration of certain policy

alternatives and procedural revisions within the defense procurement process which are proposed as a result of the impact of the evolving FMS program.

CHAPTER VI

PROPOSED POLICY ALTERNATIVES AND PROCEDURAL REVISIONS WITHIN THE DEFENSE PROCUREMENT PROCESS

The purpose of this chapter is to examine certain policy and procedural alternatives in order to respond to the subsidiary research question: What policy alternatives and procedural revisions within the defense procurement process are proposed as a result of the changing nature of the foreign military sales program?

The last three chapters have explored: (1) the evolution of the Security Assistance Program noting the increase in volume and complexity of FMS, (2) the manner in which procurements for FMS are handled within the defense procurement process, and (3) the identification and analysis of major problems associated with FMS procurements. It was suggested in Chapter IV that the approach emphasized by the DOD has been to accommodate FMS within the basic framework of the defense procurement process to the maximum extent possible. In light of the substantial growth in the FMS program and the significant problem areas identified, the present approach requires reconsideration. In so doing, this chapter addresses the following subjects:

1. A restatement of criteria for the FMS program

2. A description of alternative approaches to transacting FMS

3. An evaluation of the alternatives against the selected criteria

4. Recommended policy and procedural revisions

Restatement of Criteria for the FMS Program

In Chapter III, criteria or standards of performance for the FMS program were identified from applicable statutes, executive orders and departmental instructions. It was found that those standards set forth in legislation are of primary importance and that executive orders and departmental regulations are, or should be, reflections of the Executive Branch's interpretation or perception of the relevant statutes. Therefore, in preparing to evaluate alternative approaches to handling FMS, it is appropriate to employ criteria reflected in applicable legislation. Specifically, the following statutory excerpts have been identified as relevant benchmarks for evaluating proposed alternatives:

1. The Congressional mandate contained in Section 1 of the Foreign Military Sales Act which states that the U. S. shall reduce FMS as soon as, and to the maximum extent practicable, in favor of returning such transactions to commercial channels

2. The requirement contained in Sections 21, 22, and 23 of the Act that FMS are to be conducted at no monetary loss to the U. S.

3. The expressed sense of the Congress, also contained in Section 1 of the Act, that FMS be approved only when consistent with the foreign policy interests of the United States

Even though the criteria are to be employed in assessing policy alternatives under speculative as opposed to actual conditions, it is nevertheless appropriate to discuss operational definitions of the criteria specified above. The discussion demonstrates that it is difficult to measure performance under existing policies and procedures even without the added complication of estimating contingent conditions as they may exist if the policy alternatives are implemented.

In the case of the first criterion, reducing FMS in favor of commercial sales, an appropriate measure would appear to be a comparison of FMS orders and commercial sales orders for defense goods and services during a specified period of time. A time-series examination of the effect of a particular policy might then be possible, other things being equal. Since the export of military goods is controlled by the Department of State (as described in Chapter III), the measurement of commercial sales would appear to be straightforward; however, the statistics published by the Office of Munitions Control reflect arms exports which approximate deliveries more closely than sales orders. Although statistics for FMS deliveries can be compared with figures for commercial exports (deliveries), as is done in Chapter III, shifts in sales channels are difficult to discern since deliveries or exports represent the results of earlier decisions.

The second criterion, insuring that FMS are conducted at no monetary loss to the U. S. Government, presents many measurement difficulties, some of which were described in Chapter V. Notwithstanding the definitional problems inherent in employing terms such as "cost" and "value," the existence of inadequate accounting records presently hampers the precise measurement of the extent to which full costs are recovered. Under such circumstances, reliance must be placed primarily upon ad hoc assessments such as reports of the GAO, DOD internal audits, and other special studies. As the previous chapter stated, a sample of such inquiries indicates that full cost recovery is not being achieved under present policies and procedures. The anticipated impact of alternative policies and procedures on the cost recovery criterion can only be imprecisely assessed through analysis of the alternatives and the conditions expected to prevail.

Measuring acceptable performance under the final criterion, insuring that FMS are approved only when consistent with U. S. foreign policy interests, provides an even greater obstacle. The difficulty lies not only in defining U. S. foreign policy interests but in delineating the roles of the Legislative and Executive Branches in the realm of foreign policy. In recent years, Congress has sought to strengthen its role in foreign policy matters. One outgrowth of this development is the provision of the Foreign Assistance Act of 1974 which requires that letters of offer exceeding $25 million be submitted to the Congress for possible veto prior to acceptance

by the foreign customer. Using this legislative proviso as a measure of compliance with the foreign policy criterion provides some indication of Congressional satisfaction or dissatisfaction with actions of the Executive Branch. Of the letters of offer submitted to the Congress since the requirement became law in December 1974, none has been vetoed although the proposed sale of Hawk missiles to Jordan was withdrawn by the administration when it became apparent that Congress would disapprove the sale.[1]

This measure is not totally indicative of the disposition of the Legislative Branch since Congress has also employed other means of withholding sales of military goods, such as the direct embargo imposed on security assistance to Turkey in February 1975. It can be expected that the foreign policy roles of the Legislative and Executive Branches will continue to evolve. Therefore, the evaluation of policy alternatives must focus on the existence of a mechanism in the foreign policy area rather than upon specific outcomes.

In addition to the criteria cited above, it is also appropriate to briefly assess the anticipated impact of each of the alternatives on the major parties involved--the Department of Defense, U. S. industry, and foreign governments. Such second-order criteria facilitate consideration of other factors which should not be ignored in the evaluation of alternatives. For example, the impact of alternative policies on the U. S.

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[1]"Ford Defers Proposal to Sell Missiles," The Washington Post, July 29, 1975, p. A1.

defense posture and the political acceptability of proposed policies to the parties involved are important considerations of the type which can be given recognition.

Alternatives to be Considered

The first alternative would essentially remove FMS from the defense procurement process through the establishment of a separate executive agency to accomplish the functions presently performed by the Departments of Defense and State with respect to FMS. Such an agency could be financed under a revolving- or industrial-fund concept whereby charges for the agency's services would reflect the cost of operations. The charter of such an agency would be reflected in appropriate legislation; however, certain assumptions must be made if the alternative is to be evaluated. First, it is assumed that the agency would be statutorily obligated to recover the full cost of its operations, and second, it is assumed that the Congress would require the establishment of a mechanism to insure that transfers of military goods and services are approved only when consistent with U. S. foreign policy interests.

The second alternative involves a major modification of the manner in which FMS procurements are handled within the defense procurement process. The modification entails making FMS transactions approximate commercial sales while retaining them under the umbrella of a government-to-government agreement. Elements of such a modification would include the following:

1. Revising ASPR cost principles to allow recognition of costs normally permitted in commercial transactions but not

reimburseable under defense contracts, e.g., interest and advertising expenses

2. Permitting commercial-type payments (advance deposits and milestone payments) that closely approximate the contractor's actual cost-incurrence experience

3. Refusing to permit the exercise of options for FMS requirements which have the effect of employing the purchasing power of the U. S. Government to the detriment of the contractor

4. Citing foreign trust funds rather than U. S. reimburseable appropriations directly on FMS contracts[1]

5. Making discretionary socio-economic provisions nonapplicable to FMS transactions

The third alternative involves making only minor modifications within the defense procurement process to continue the concept of contracting for FMS and DOD requirements on the same basis to the maximum extent possible. As indicated in Chapter IV, the present standard for FMS procurements is set forth on the reverse of the DD Form 1513, Letter of Offer and Acceptance, wherein the U. S. agrees: (1) to procure goods and services for the foreign purchaser under the most advantageous terms and conditions available consistent with DOD regulations and procedures, and (2) when procuring, to employ the same contract clauses, the same contract administration, and the same

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[1]The purpose of this element is to facilitate the accomplishment of two of the other elements--the use of commercial payment terms (e.g., present law limits the use of advance payments where U. S. funds are involved) and the application of certain socio-economic provisions (e.g., renegotiation applies when U. S. funds are cited).

inspection procedures to the extent possible. This latter alternative focuses on retaining the basic concept while making minor modifications within the existing procurement framework in response to the problems identified. Specifically, such modifications would be aimed at (a) aligning policies and procedures more closely with expressed Congressional intent (such as revising the definition of commercial availability so as to encourage the greater use of the commercial sales channel and strengthening cost recovery guidelines in order to reduce the subsidization of FMS by the U. S. Government), (b) clarifying policies and procedures (such as elaborating on how to apply the FMS special profit factor), and (c) eliminating inconsistencies in the application of FMS policies and procedures (such as correcting the variations in assignment of contract administration functions for FMS procurements).

Evaluation of Alternatives

The pattern followed in this section is to evaluate each alternative: (1) establish a separate executive agency, (2) make major modifications within the defense procurement process, and (3) make minor modifications within the defense procurement process; against the primary criteria: (a) return sales to commercial channels, (b) insure full cost recovery, and (c) insure consistency of FMS with U. S. foreign policy; and the second-order criteria: (i) anticipated impact on the DOD, (ii) anticipated impact on U. S. industry, and (iii) anticipated impact on foreign governments. The evaluation is summarized in Table 6 wherein the term "favorable" indicates that the

TABLE 6

EVALUATION OF ALTERNATIVES

Criteria	Alternatives: Create Separate FMS Agency	Make Major Modification	Make Minor Modification
1. Return sales to Commercial Channels	Unfavorable (depends on agency charter)	Unfavorable (higher ratio of FMS likely)	Favorable (revise definition of commercial availability)
2. Insure full Cost Recovery	Favorable (depends on agency charter)	Unfavorable (higher cost to recover)	Favorable (revise recovery policies)
3. Consistency of Sales with Foreign Policy	Favorable (depends on agency charter)	Favorable (procedure existing)	Favorable (procedure existing)

TABLE 6 - Continued

Anticipated Impact on	Alternatives		
	Create Separate FMS Agency	Make Major Modification	Make Minor Modification
1. Department of Defense	Unfavorable (poor coordination of USG/FG Weapons programs; poor control over producers)	Unfavorable (increase in ratio of FMS; differs from DOD procurements)	Unfavorable (heavy workload, but within DOD framework)
2. Industry	Unfavorable (coordination required with DOD and new agency)	Favorable (more FMS at terms beneficial to industry)	Unfavorable (desires commercial terms)
3. Foreign Governments	Unfavorable (new relations to cultivate)	Unfavorable (higher prices likely)	Favorable (continues original concept)

alternative is supportive of the criterion, and the term "unfavorable" denotes the opposite outcome.

Establish a Separate Executive Agency

With regard to the first criterion, reducing FMS and returning sales to commercial channels, it is not certain that a separate executive agency to administer FMS would succeed in returning sales to commercial channels even if the existing mandate to that effect were carried over to the new agency's charter. In fact, the institutionalization of FMS in a new agency might well produce the opposite effect.

A secondary consideration is that Congress may be less than totally committed to increasing commercial sales of arms. Many of the legislative proposals that have been introduced in the current session of Congress are aimed at placing more stringent controls on sales through government-to-government channels. One Representative notes the controversy over sales channels and observes that, "many Congressmen believe that stricter controls are needed and, to the extent possible, all sales should be run on a government-to-government basis."[1]

In the establishment of a separate agency to administer FMS, the use of a revolving- or industrial-fund concept accompanied by an adequate accounting system should insure that costs are fully recovered through the application of appropriate surcharges to sales transactions. Such charges would require

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[1]Les Aspin, Member of the U. S. House of Representatives, Press Release, Washington, D.C., August 19, 1975, p. 2.

periodic adjustment to assure that the operating and capital costs of the agency are borne by the users of the organization's services who would include foreign governments and departments of the U. S. Government when grant aid programs are implemented through the new agency.

To insure that FMS are approved only when consistent with foreign policy interests of the U. S., it is reasonable to assume that, in chartering an FMS agency, the Congress would require the establishment of a mechanism suitable to both branches. The respective foreign policy roles of the Congress and the administration might well be fashioned through the veto/override process in arriving at an appropriate charter for the new agency.

In assessing the impact of this alternative on the DOD, there are numerous factors that must be considered. Although the creation of a separate executive agency to administer FMS would be expected to free many DOD manpower resources presently engaged in supporting FMS,[1] there are other factors of a negative nature that must be addressed:

1. Added difficulty in coordinating weapon requirements with foreign governments

2. Less control over domestic weapons producers

3. New problems in coordinating defense procurements with purchases of the new FMS agency (e.g., establishing delivery

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[1]A knowledgeable respondent estimates that between 8,000 - 10,000 personnel in the U. S. Air Force alone are involved in FMS support on a full- or part-time basis.

priorities, possible higher prices due to split requirements, logistics support considerations, administration of grant aid requirements)

Most importantly, it is doubtful that the creation of a separate agency would resolve many of the procedural problems identified in the preceding chapter. The newly-created agency would likely be required to operate under the Federal Procurement Regulation (FPR) as are the majority of non-defense federal agencies.[1] The FPR is patterned after the ASPR in many respects but does not contain guidance concerning FMS. Therefore, the new agency would be confronted with developing procedural instructions without the benefit of prior experience in conducting FMS transactions. It is logical to expect that the new agency, in developing FMS policies and procedures, would draw heavily upon the ASPR and the expertise available from within the Department of Defense. Whatever deficiencies exist in the ASPR might well be transmitted to the procurement regulations of the new agency through the developmental process.

The creation of a new agency to administer FMS would impose a new set of relationships on U. S. defense contractors. The establishment of an organization responsible for purchasing weapons on behalf of foreign governments would complicate the planning, coordination and production of weapon systems since the DOD would no longer be the only customer (not considering direct commercial sales) for such systems. In addition, over

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[1]U. S., General Services Administration, Office of Federal Management Policy, Federal Procurement Regulation, 1964 Edition.

a period of time, the new agency might impose procurement rules that differ from those of the DOD in areas such as pricing, cost allowability and government-furnished property. Industry would logically be expected to oppose such a development.

Foreign government representatives responsible for purchasing defense goods and services often develop close working relationships with officials of the Department of State and DOD representatives such as military advisors assigned to the foreign country. The displacement of these relationships through the creation of an FMS agency would likely be unfavorably regarded by most foreign governments and might be vigorously opposed by some.

In addition, the assurance that DOD will use and support the same weapon system is sometimes the overriding consideration in a foreign government's decision to purchase military hardware in the United States. Such assurances might not be forthcoming from a separate FMS agency.

Major Modification Within the Defense Procurement Process

This alternative can be characterized as an industry proposal since the elements of the modification would largely be beneficial to contractors--greater cost recognition, more favorable cash flow, fewer restrictive contractual provisions, and so forth.[1] With regard to the first criterion, reducing

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[1]Aerospace Industries Association of America, Inc., "Revision of Procurement for the FMS Program," White Paper, July 1975.

FMS in favor of returning sales to commercial channels, the effect of this alternative might be to increase the ratio of FMS to commercial sales. Industry would be able to retain the FMS "umbrella" while benefitting from the more favorable terms offered under this approach.[1] Many foreign governments, particularly those not possessing indigenous procurement expertise, would continue to prefer the government-to-government channel choosing not to deal directly with representatives of U. S. industry.

To the extent that the costs of conducting FMS are not fully recovered under existing policies and procedures, the continuation of such treatment accompanied by an increase in the ratio of FMS to commercial sales could result in even greater under-recoupment of costs. In addition, the modification of the defense procurement process to treat FMS more like commercial sales transactions could be expected to increase the administrative burden of handling such sales. In other words, the differences between DOD and FMS procurements (cost allowance provisions, payment terms, and so forth) would accentuate the administrative workload associated with FMS. In the extreme case, it might be necessary to use separate contracts to obtain U. S. and foreign government requirements

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[1]An example will illustrate the value of the FMS channel to a contractor. When the Congress imposed the arms embargo on Turkey in February 1975, contractors who had commercial sales agreements with the Turkish Government were, in some instances, left with fully- or partially-completed orders unpaid. On the other hand, the U. S. Government accepted delivery and made payment for FMS orders, but did not transfer the goods to Turkey.

which are presently procured on a consolidated basis.

It is not envisioned that the major modification approach would alter the existing mechanism for insuring that FMS are approved only when consistent with U. S. foreign policy interests. As described in Chapter III, the roles of the Departments of State and Defense and the Congress are addressed in present procedures relating to the approval of specific categories of foreign military sales. Although differences of opinion may obviously exist with respect to the advisability of consummating a particular sale, the mechanism is exercised in each case. Under present law, the Secretary of State has the primary authority to approve FMS. The major modification alternative would not alter this assignment.

In addition to the conjecture that a major modification of the defense procurement process as described above would increase the ratio of FMS to commercial sales, there are other factors that might have an unfavorable impact on the DOD. The creation of a set of FMS policies and procedures differing significantly from normal DOD purchases could be costly from both an administrative and a technical standpoint. The increased workload brought about by the differing systems would be accompanied by a need for a frame of reference within which to operate. The FMS system would initially function without the traditional benchmarks provided by the present treatment of FMS as DOD procurements. Where contracting officers are now guided by DOD procurement regulations and a framework of administrative and judicial decisions applicable to defense procurement, the

FMS procurement system would be lacking a similar supporting structure.

The major modification approach is consistent with the view held by some industry representatives that the U. S. Government should serve primarily as an intermediary in bringing foreign buyers and domestic suppliers together. The establishment of a system for FMS procurements which more closely approximates commercial terms while retaining many of the favorable aspects of a government-to-government agreement represents a perceived improvement from the standpoint of industry.

The major modification to the defense procurement process represents a significant change in the traditional standard for handling FMS transactions from the viewpoint of the foreign government. This aspect alone might be expected to draw an unfavorable response from many foreign buyers. In addition, to the extent that higher prices result from the application of more liberal cost principles and payment terms, foreign governments would logically be opposed to this approach. The value of the government-to-government agreement would be depreciated in the eyes of most foreign customers.

Minor Modification Within the Defense Procurement Process

Under the existing mandate to reduce FMS and return sales to commercial channels, the revision of DOD rules defining commercial availability in a manner that would encourage greater use of the direct sale method should be favorably received. The

designation of a greater number of selected categories of defense goods and services as "commercially available" would be responsive both to the statute and to the long-standing industry criticism that the U. S. Government defense inventory competes against domestic suppliers for some foreign sales. A related favorable facet of this alternative would be the encouragement of foreign governments to develop greater procurement expertise and to establish procurement missions in the U. S. to handle both FMS and direct commercial transactions.

Similarly, the revision of defense procurement policies and procedures aimed at insuring greater cost recoupment on FMS transactions should be favorably considered in light of the statutory cost recovery criterion. In particular, greater recoupment of nonrecurring research, development and production costs and recurring administrative costs could be accomplished without major modifications to the defense procurement process since the basic mechanism for recovery is already in existence. Improved identification, recording and reporting of such costs are needed to facilitate the judgment of performance under this criterion.

Under the minor modification approach, the existing mechanism for insuring that FMS are approved only when consistent with foreign policy interests of the U. S. would be retained.[1] Although the respective roles of the Legislative and Executive

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[1]The categorization of foreign purchasers and the respective roles of the Departments of State and Defense in approving FMS are addressed in Chapter III.

Branches will continue to evolve in the area of foreign policy, the present mechanism complies with current statutory requirements and is effectively exercised in the approval of foreign military sales.

The minor modification approach has the undesirable feature of continuing a heavy DOD involvement in and commitment to FMS; however, the retention of FMS transactions within the defense procurement framework lessens the unfavorable impact. Consistent cost principles, payment terms and contract provisions for FMS and DOD procurements minimize the unique treatment of FMS. In many instances, U. S. and foreign government requirements can be combined under a single contract. The planning of common weapon requirements, the control of production and the scheduling of deliveries are facilitated by a single procurement system.

In many respects, the minor modification approach is most like the present FMS environment. As indicated previously, some industry representatives are critical of numerous aspects of the rules currently applied to FMS procurements (inadequate payment terms, nonallowability of interest and advertising expenses, inequitable use of options and overzealous negotiations by the U. S. Government on behalf of a foreign customer). Since industry apparently desires that FMS be conducted under conditions which more closely approximate commercial transactions, the minor modification approach is not likely to be favorably received.

The minor modification alternative continues the

traditional concept of contracting for FMS and DOD requirements on the same basis to the maximum extent possible; therefore, it would be favorably regarded by foreign governments interested in retaining the FMS channel. Although the tightening of cost recovery procedures could be expected to result in higher prices to foreign governments, the retention of a readily accessible means to employ the procurement expertise of the DOD would more than offset the undesirable aspects of the minor modification approach.

Proposed Revisions to FMS Procurement Policies and Procedures

Having determined that the minor modification approach is the alternative supported by the preceding analysis, the report now proposes certain policy and procedural revisions. These proposals are aimed at: (1) clarifying existing defense procurement policies and procedures as they relate to FMS transactions, (2) aligning them more closely with expressed Congressional intent, and (3) eliminating inconsistencies in the application of such policies and procedures. By responding to the problem areas identified and addressing proposed revisions within each phase of the procurement process--exogenous factors, planning, source solicitation, selection and award, and contract administration--the research seeks to synthesize recommendations drawn from many sources and to present them in a manner that integrates the phases of the process into a comprehensive whole. These sources include reports of the ASPR FMS Subcommittee, DOD internal reports, GAO reports and industry documents.

Exogenous Factors

Funding and needs determination were identified as exogenous influences upon the defense procurement process; however, it was found that certain aspects related to these factors have a direct effect on procurement policies and procedures.

Funding of FMS procurements

The funding of FMS procurements varies from one military department to another and even within the same department. Although the reimburseable method--citing U. S. appropriated funds which are subsequently replaced by foreign trust funds--is the predominant approach employed, foreign trust funds are directly cited in numerous instances, particularly by the U. S. Navy.

A recent DOD study concluded that there is a need for greater standardization among the military departments in FMS billing, collection, trust fund accounting and reimbursement requirements. The report recommends that OSD further investigate alternative approaches to standardization in the funding area. The establishment of a single FMS fund control office to accomplish FMS financial functions for all military services is one possibility, while greater standardization could also be achieved through the prescription of more detailed procedures to be used by the individual services.[1]

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[1]U. S., Department of Defense, Logistics Systems Compatability Review Group, International Logistics Program Systems Review, May 1975, pp. VI-20, VI-21.

This research supports the conclusion of the DOD study that standardization of FMS funding should be given serious consideration; however, whether or not such uniformity is pursued, additional procurement guidance is needed. Since direct citation and reimburseable approaches are presently authorized, procurement regulations ought to address the legal implications of each method of funding FMS procurements. In other words, if the direct citation of foreign trust funds in a FMS procurement causes certain statutory and regulatory provisions to be nonapplicable, as in the case of the renegotiation requirement, this information should be included in the ASPR for the guidance of procurement personnel in determining the appropriate funding method.

The Air Force is presently conducting a review of contract clauses contained in the ASPR to determine which are applicable to FMS procurements. One element of that review should be to ascertain the extent to which the funding method chosen alters the applicability of statutory and regulatory provisions.

The process of needs determination

As described in Chapter V, the process of needs determination with respect to FMS procurements differs significantly from the rigorous procedures employed in documenting U. S. defense requirements. Requests for letters of offer from a foreign government may be received "out of cycle," i.e., production plans may have already been finalized. Alternatively, the DOD may receive a request for a letter of offer from a foreign

government and may alter its own plans and find that the foreign government does not respond to the letter of offer.[1] Finally, orders may be received in a piecemeal fashion so as to preclude consolidation and the usual favorable impact on price which accompanies combined purchases.

There are several aspects to proposals in this area that should combine to produce a favorable effect on needs determination for FMS procurement. First, the Department of State officials and the military advisory groups who work with foreign governments that make substantial annual purchases of U. S. military hardware need to encourage greater advance planning and budgeting of defense needs by those governments. Potential benefits to the foreign governments would include more favorable prices and delivery schedules in cases when proposed purchases could be forecasted and planned in a more optimal manner.

Second, the DOD should continue to seek authorization for inventory replenishment funds to be used in anticipation of foreign military sales and to offset the unfavorable impact on U. S. inventories and production in instances when foreign governments' requests must be fulfilled on an expedited basis. The Fiscal Year 1976 defense budget included a request for $300 million to establish such a fund; however, it does not appear that such authorization will be granted at this

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[1]When a letter of offer is not accepted by the foreign government, there is presently no means to recover the cost of preparing the offer. Perhaps the U. S. Government should consider requiring payment for the preparation of letters of offer that are rejected by the requester.

time.[1]

Additionally, at least one of the military departments is exploring the greater use of flexible contracting techniques to facilitate FMS procurements, to increase responsiveness of the procurement process to customer demands and to minimize the unfavorable impact of foreign government purchase decisions on U. S. defense requirements. Such techniques would include the increased use of options in the basic contract for additional quantities of the major item, spare parts and support equipment. Further, the use of requirements contracts or indefinite quantity contracts is being considered.[2]

The Planning Phase

In the planning phase of the FMS procurement cycle, various problems associated with the preparation of the pricing and availability study and the finalization of the letter of offer were identified. Recommendations are made with respect to each of these areas.

Preparing the pricing and availability study

The major problems cited center on two issues--the time allowed for the completion of the pricing and availability study and the involvement of procurement and contractor personnel in

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[1]U. S., Department of Defense, Secretary of Defense, Annual Report to the Congress, FY 1976 and FY 197T, February 5, 1975, p. IV-30.

[2]U. S., Department of the Air Force, Deputy Chief of Staff/Systems and Logistics, Directorate of Military Assistance and Sales, Security Assistance Impact Study, December 1974, Panel D, Task N, pp. 1-2.

the development of the price estimates. In regard to the time allowed for the pricing study, the DOD specifies that an offer in response to a foreign government's request must be submitted within a period of six weeks. The military services require an even shorter response time. The consensus is that the pricing of major items of equipment, particularly when peculiar configurations are desired, requires more than six weeks' preparation time, while estimates concerning standard, off-the-shelf items demand substantially less time to complete. Therefore, the Military Assistance and Sales Manual should be revised to reflect submission times based on the scope and complexity of the item(s) requested. The additional investment of time in developing a sound initial estimate for a major FMS transaction should result in fewer price revisions subsequent to the acceptance of the letter of offer by the foreign government.

Program/project offices employ various approaches in the preparation of pricing and availability studies. In some instances, the procurement and contractor personnel who will be concerned with pricing any contract resulting from the letter of offer are either minimally involved or are ignored in the development of the study. The ASPR FMS Subcommittee has recommended that the ASPR be modified to require the contracting officer's participation in the pricing and availability study.[1]

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[1]U. S., Department of Defense, Chairman, ASPR FMS Subcommittee, Memorandum for the Chairman, ASPR Committee, Subject: "ASPR Cases 74-118 and 73-88," August 7, 1975, paragraph 6-1302.1(b).

This revision should be adopted to facilitate the early involvement of the functional personnel who will be responsible for the subsequent FMS contract.

The above proposals address certain procedural and organizational aspects of pricing studies. From a practical standpoint, some of the program/project offices employ computerized pricing models to enable timely responses to expedited requests for pricing and availability data. When the volume of FMS activity and the availability of data processing facilities permit, other program/project offices should favorably consider such an approach.

Finalizing the letter of offer

The major shortcomings noted with respect to finalizing the letter of offer revolve around a failure to communicate the intent of the parties to the agreement. Specific problems included: (1) failure to designate a single source of supply when desired by the foreign government, (2) omission of necessary support equipment, parts or services, and (3) failure to indicate procedural variations agreed upon in preparing the letter of offer.

The best opportunity to avoid communication problems with regard to the letter of offer is to place increased emphasis on clear communication during the preparation of the sales agreement. The organizational mechanism employed in conducting FMS procurements, wherein security assistance personnel are responsible for the letter of offer while procurement personnel are responsible for the FMS contract, contributes to the problems

noted. A proposal that deserves consideration is the establishment of either a permanent panel or an ad hoc committee comprised of representatives of concerned functional elements (security assistance, procurement, logistics, training, and so forth) to critically review each major letter of offer prior to submitting it to the foreign government. Each representative would concentrate on ascertaining the adequacy of the letter of offer as it relates to his functional area. In some instances, it would be desirable to include participation by the foreign customer in the review. Such a corporate review should be specified in the Military Assistance and Sales Manual for major cases and could be required by military department regulations for lesser cases.[1]

Once the letter of offer is accepted by the foreign government, prompt notice and funding should be provided to the procuring activity to permit the ordering of long-lead time items and the carrying out of commitments made during the preparation of the offer.

The Source Solicitation Phase

The problems identified in this phase of the procurement process relate to the selection of the channel for the sale--clarifying the definition of commercial availability, resolving the transfer of government-furnished equipment, and implementing

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[1]A review of the letter of offer should not require an inordinate length of time. For cases exceeding $25 million, the review could be accomplished during the twenty-day period specified for Congressional consideration of the proposed sale.

offset purchase agreements. Proposals are made with respect to each of these areas.

Defining commercial availability

Although the Foreign Military Sales Act of 1968 was revised in 1973 to reflect a Congressional preference for direct commercial sales of defense goods and services in lieu of FMS, little has been done to clarify or expand the definition of commercial availability contained in the Military Assistance and Sales Manual. Notwithstanding the fact that military advisors assigned to foreign governments have been instructed to encourage greater use of the commercial sales channel, it appears that more aggressive action is required if FMS are to be diverted to commercial channels. One such proposal relative to government-furnished equipment is addressed in the following section. Individual classes of items categorized as not commercially available should be scrutinized and reclassified if circumstances permit. A relevant consideration is whether normal export licensing requirements imposed by the Department of State would suffice to control the release of the item in question.

The General Accounting Office has made certain recommendations aimed at encouraging a shift from FMS to direct commercial sales. With regard to the leading customer for U. S. military goods and services, the Government of Iran, the GAO has suggested that the DOD consider: (1) helping Iran establish a mission in the U. S. for the purpose of making direct purchases from suppliers, or (2) providing procurement advisors

in lieu of FMS to reduce the significant numbers of highly trained U. S. military personnel involved in government-to-government sales.[1] It would appear that the GAO proposals may have merit with respect to other customers as well.

Resolving government-furnished equipment (GFE) issues

It was found that GFE is often a prime determinant of the sales channel chosen, particularly in the case of major weapon systems, since most such systems contain GFE compenents. Since GFE cannot be transferred to private parties, the FMS channel must be used to consummate the sale. Despite this requirement, some sales are concluded on a mixed-channel basis with the primary item being transferred commercially while the GFE components are handled as an FMS case either with the foreign government directly or with the prime contractor acting as an agent of the foreign government. Such mixed-channel sales create problems in coordination, cost recovery and in delineating the responsibilities of the foreign government, the U. S. Government and the contractor.

The Defense Security Assistance Agency is sponsoring a current legislative proposal which would permit the sale of GFE to private parties under certain circumstances.[2] The proposed

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[1]U. S., General Accounting Office, Issues Related to U. S. Military Sales and Assistance to Iran, B-133258, October 21, 1974, p. iii, (unclassified digest of the report).

[2]General Counsel of the Department of Defense to Speaker of the House of Representatives, Subject: "Proposed Legislation to Amend Title 10, U. S. Code," April 23, 1975. Essentially the same recommendation was submitted in 1971 as a part of the proposed International Security Assistance Act (Section 62(f)(1)) and in 1974 as House Resolution 13436. In neither case was the proposal enacted into law.

statute would authorize the negotiated sale of DOD property, either from inventory or from new procurement, to a U. S. purchaser for incorporation of the property into an end item being sold to an eligible foreign government or international organization. The authority would be restricted to instances when the GFE is available only from the DOD or when it is not commercially available at such time as may be required to meet the schedule of the U. S. contractor in delivering the end item.

The DOD has advised the Senate Foreign Relations Committee that the proposal would allow the U. S. Government "to return to wholly commercial export channels those sales transactions which now must be conducted under the authority of the Foreign Military Sales Act" because a necessary component of the end item is GFE.[1] The direct sale of the end item would be subject to Department of State munitions export control requirements. The extent to which the requested authority would be instrumental in reducing FMS is uncertain.

Two aspects of the proposal are a matter of concern. First, it would appear necessary to establish controls for the purpose of insuring that sales of GFE to private contractors are limited to the circumstances noted above. Second, the price to be charged for the GFE would be subject to negotiation. If GFE were sold at less than market value, the DOD could be accused of subsidizing the purchaser of the GFE to the detriment

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[1] U. S., Congress, Senate, Committee on Foreign Relations, Foreign Assistance Authorization, Hearings before the Committee on S.3394, 2d sess., 1974, p. 248.

of the GFE supplier and to other contractors competing for the sale of the end item.

Although the approval of the proposal would likely have the effect of reducing FMS by diverting some sales to commercial channels, the authority would have to be carefully delineated to avoid potential abuses. Whether or not the proposed legislation is enacted, the DOD should consider discontinuing the mixed-channel approach that is presently used. It appears that the administrative complexities created by the approach coupled with the questions raised concerning the adequacy of cost recovery in such circumstances more than offset the benefits of having a portion of the sale transacted commercially.

Implementing offset procurement arrangements

Although DOD policy continues to reflect a preference for FMS agreements unencumbered by offset purchase arrangements, economic circumstances are increasingly causing foreign governments to seek opportunities for reciprocal sales when purchasing in the U. S. through the FMS channel. When circumstances result in offset commitments, the DOD prefers that the contractor benefitting from the foreign sale fulfill the offset agreement.

Proposed policies and procedures to implement offset procurement arrangements have been recommended to the ASPR Committee to compensate for the existing void in guidance

related to this area.[1] Specifically, the suggested coverage provides for: (1) a contractual provision addressing the contractor's obligations with respect to fulfilling any offset commitment associated with the FMS agreement, and (2) a solicitation notice to accompany DOD procurements which may be applied against an offset program. The notice indicates that foreign sources are being solicited and specifies bid evaluation procedures applicable to such procurements, i.e., waiver of Buy American or gold flow requirements may be stipulated.

Although the proposed ASPR coverage should resolve many of the present shortcomings noted, an increasingly troublesome area has not been addressed. In some instances when contracts for DOD requirements are awarded to foreign sources under an offset arrangement, there is difficulty in reaching agreement on the terms to be included in the contract. Some of the more troublesome provisions which the U. S. seeks to include and the foreign source seeks to exclude are related to Cost Accounting Standards (P.L. 91-379), audit by the DOD, examination of records by the Comptroller General, and so forth. It is unlikely that it will be possible in the near-term to specify in the ASPR which clauses are applicable to contracts with sources in various countries. However, it may be feasible to begin to explore the development of basic agreements between the U. S. and individual governments which would address the

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[1]U. S., Department of Defense, Chairman, ASPR FMS Subcommittee, Memorandum for the Chairman, ASPR Committee, Subject: "Case 74-130, Implementation of Offset Arrangements Included in FMS Agreements," April 3, 1975.

types of contractual provisions that will be recognized by both parties in future contracts.

The Selection and Award Phase

In the previous chapter, the following problem areas were identified in the selection and award phase: (1) pricing to recover full costs, (2) payment of agent's fees, (3) special profit consideration for FMS, (4) financing arrangements under FMS contracts, and (5) exercising options for the benefit of FMS requirements. Proposals relating to each of these areas are addressed in this section.

Achieving full cost recovery

Analysis of the rules, regulations and practices governing the pricing of FMS procurements reveals that the recovery of full costs has been a problem, particularly with regard to unfunded costs. Such costs include administrative expenses and sunk investment outlays associated with FMS procurements. The reimbursement of recurring administrative costs is addressed later in this chapter.

A recent DOD Instruction which took effect in October 1975 is aimed at correcting some of the shortcomings with respect to the pricing of FMS procurements which were recounted in the preceding chapter.[1] Specifically, the revised instruction provides for the recoupment of charges for the use of DOD

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[1]U. S., Department of Defense, Assistant Secretary of Defense (Comptroller), Pricing of Sales of Defense Articles and Defense Services to Foreign Countries and International Organizations, Instruction 2140.1, June 17, 1975, para. X.

facilities and equipment. An asset use charge of four percent is to be applied to direct costs being billed on FMS orders by DOD industrial facilities (such as arsenals and repair depots) and government-owned, contractor-operated facilities (such as many of the Army's ammunition plants). The asset use charge is designed to facilitate computation of the value added through the use of DOD assets and is in lieu of separate computations of such costs as depreciation, attrition, or imputed interest on investment. The asset use charge is to be applied to FMS orders calling for new production, repairs and modification, training, and transportation.

Although the revised instruction responds favorably to several of the criticisms voiced by the GAO, a related portion of the modified directive points up an existing conflict in the ASPR. The new instruction specifies that charges for the use of DOD assets located at contractor-owned, contractor-operated facilities are to be in the form of rental rates, and that applicable procedures are set forth in the ASPR.[1] However, as indicated in Chapter IV, the ASPR permits most use of government-owned property for the benefit of foreign sales to be granted on a rent-free basis. The ASPR Committee recognizes this inconsistency and is presently considering a revision to the rent-free use provision. In light of the statutory requirement to recover full costs and the GAO interpretation thereof, it appears that the ASPR should be modified to provide for the

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[1]Ibid.

collection of rental charges when contractors use DOD facilities and equipment for the benefit of foreign military sales and direct commercial sales to foreign governments. Exceptions might continue to be granted in cases when the U. S. receives similar benefits from foreign governments. An example would be a co-production situation in which foreign facilities are being used to produce items for use by the U. S. Government.

Chapter IV cited evidence that nonrecurring research, development and production costs are not being fully recovered. Inadequate policy and procedural guidance may have contributed to the under-recoupment. An Air Force study offered the following recommendations with respect to improving such policies and procedures:[1]

1. Revise DOD Directive 2140.2 and the ASPR to provide for the pro rata sharing of initial tooling and production start-up costs among subsequent purchasers of the item

2. Revise DOD Directive 2140.2 and the ASPR to require the foreign government to fund development costs for peculiar modifications requested by that government (as is the case for nonrecurring production costs associated with peculiar changes)

3. Revise the ASPR to address the responsibilities of the U. S. Government and the contractor in the pro rata sharing of the cost of engineering changes benefitting both U. S. and FMS end items

4. Provide ASPR guidance regarding the responsibilities

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[1] Security Assistance Impact Study, Panel D, Task K, pp. 4-5.

of the U. S. Government and the contractor for the collection of pro rata charges for nonrecurring research, development and production costs in joint FMS/direct commercial sale transactions

Finally, the policy governing the waiver of recoupment for nonrecurring research, development and production costs needs to be made more definitive. At the present time, the Director, Defense Security Assistance Agency, is authorized to waive recoupment when such action is deemed to be in the best interests of the United States Government.[1] In light of the statutory cost recovery mandate, specific criteria for the granting of waivers should be promulgated.

Treatment of agent's fees

The problem of determining the allowability and reasonableness of agent's fees or commissions on FMS procurements has been exacerbated by the increased volume and complexity of such transactions. Some of the specific difficulties encountered include: (1) the effect of varying business practices in foreign countries, (2) a lack of visibility as to what a particular agent's fee includes, (3) the application of small percentage rates which result in large dollar fees, and (4) the inadequacy of evaluation tools for use by the contracting officer in determining the allowability and reasonableness of

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[1]U. S., Department of Defense, Assistant Secretary of Defense (Comptroller), Recovery of Nonrecurring Costs Applicable to Foreign Military Sales (FMS), Directive 2140.2, January 23, 1974, para. VI.

agent's fees.

Recent DOD policy guidance has attempted to address the problems connected with the payment of such fees and to reduce the growing criticism surrounding the subject. Features of the new guidance include:[1]

1. Agent's fees or commissions shall not be included in contracts for FMS requirements of the governments of Iran, Israel, Kuwait and Saudi Arabia unless payment of the fee has been specifically approved by the respective government prior to award (previously applicable only to the Government of Iran)

2. Proposed agent's fees are to be identified and evaluated at the time the letter of offer is being prepared rather than at the time the FMS contract is being awarded

3. The foreign government is to be advised of any proposed agent's fee at the time the letter of offer is submitted for acceptance

4. The notice to the foreign government will indicate whether or not the DOD considers the proposed fee to be reasonable or will indicate that the DOD cannot determine the reasonableness of the fee

5. Acceptance of the letter of offer will constitute approval of the proposed fee

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[1]Director, Defense Security Assistance Agency, Teletype to the Military Departments and Military Assistance Advisory Groups, Subject: "Agent's Fees/Commissions for Foreign Military Sales," August 6, 1975.

The above guidance represents an improvement over earlier instructions primarily because of the emphasis placed on identifying and disclosing any proposed fee prior to consummation of the sale. However, the need for better tools to assist in determining the reasonableness of agent's fees remains. It appears that contractors should be required to submit substantiating documentation to establish the bona fide nature of the agency relationship and the nature and extent of the services rendered or to be rendered in return for the fee. The amount of the fee should remain subject to the judgment of the contracting officer responsible for awarding the contract. In this regard, one of the military services is presently examining the feasibility of establishing a data bank for past agent's fees paid (accompanied by the essential characteristics of each case) to assist contracting officers in making determinations of reasonableness in similar situations.

Determining FMS special profit consideration

The problem areas associated with determining profit entitlement of FMS procurements include: (1) differentiating between cost and profit factor criteria, (2) specifying the types of procurement actions to which the special profit consideration is intended to apply, and (3) determining the size of the profit factor to allow under the specified criteria.

Several proposals have recently been advanced by the ASPR FMS Subcommittee with respect to the special profit

consideration for FMS.[1] Specifically, the subcommittee has recommended that:

1. The present definitions of selling costs and product support/post-delivery service costs contained in ASPR 6-705.3(c) be expanded and made more explicit

2. The criteria for application of the special profit factor in ASPR 3-808.6(b) be revised to indicate that the contractor must demonstrate active involvement in initiating the sale and that not all sales qualify for special profit

3. The special profit factor not be applied to sales from DOD inventories or stocks or to procurements for replenishment of such inventories or stocks

These recommendations generally respond favorably to the problem areas identified. Although the suggested revisions should assist contracting officers in differentiating between FMS cost and profit factors, the size of the profit factor to be allowed in a specific case remains a matter of judgment. The one to four percent range for the profit factor is effectively being changed to zero to four percent since, under the recommended coverage, the contracting officer would now be able to make a determination that the contractor did not actively engage in making the sale and therefore is not entitled to the additional profit consideration.

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[1]U. S., Department of Defense, Chairman, ASPR FMS Subcommittee, Memorandum for the Chairman, ASPR Committee, Subject: "ASPR Cases 74-118 and 73-88," August 7, 1975.

Financing and payment terms under FMS contracts

The major industry criticism with respect to the policies and procedures governing FMS procurements has involved the adequacy of financing terms offered. Under the terms and conditions of the DD Form 1513, Letter of Offer and Acceptance, FMS contracts normally contain standard DOD progress payment or cost reimbursement provisions, depending on the type of contract being used. In either case, the contractor is reimbursed at a rate of eighty to eighty-five percent as work progresses under the contract. Contractors contend that commercial-type payment terms (advance and milestone payments) should be permitted to reduce the need for external financing of FMS contracts. The payment of interest for such financing is not recognized as an allowable cost under DOD cost-reimbursement type contracts.

This matter has been extensively studied by the DOD, and the following proposals were recently given tentative approval by the ASPR Committee:[1]

1. Revise ASPR 6-705.3(b) to indicate that, when commercially available items are being procured through FMS channels, it is appropriate to recognize a contractor's established commercial payment terms through the application of a special profit factor

2. Establish in ASPR 3-808.6(b) a range of zero to three percent of recognized costs for the special profit factor

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[1]Ibid.

3. Establish the following criteria to govern selection of the specific profit factor percentage:

a. The contractor's commercial payment terms are published

b. Such terms are consistent with the contractor's normal business practices relative to the item or similar items sold commercially over a long period of time or in substantial quantities

c. A determination of the cost of capital under the alternate financing arrangements (U. S. Government terms versus commercial terms) will be necessary to demonstrate the adverse impact of non-commercial payment provisions

One industry association has already recorded its opposition to the changes recommended by the ASPR Committee:

> AIA believes that minimizing or eliminating financing costs through improved payment terms would be more equitable to all parties. The payment of additional profit to offset an expense that might have been avoided is not an attractive solution, the probability of negotiating and retaining such additional profit is not high, and 1-3% added profit is not adequate compensation in most cases.[1]

Nevertheless, the approach being considered by the DOD appears to be consistent with past efforts to minimize the differences between DOD and FMS procurements. The revision of payment terms for FMS contracts or the modification of ASPR cost principles to recognize interest expenses on FMS contracts would constitute major modifications to procurement policies

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[1]Aerospace Industries Association of America, Inc., "Revision of Procurement for the FMS Program," White Paper, July 1975, p. 2.

and procedures. The use of a special profit factor to compensate for the contractor's reduced cash flow is also consistent with the existing special profit factor used to compensate for contractor marketing efforts which are not fully recognized in the contract price. The alleged inadequacy of the proposed special profit factor for contract financing must be tempered by a consideration of the value of the FMS channel to the contractor. The DOD approach may encourage increased direct commercial sales to the extent that such terms are perceived as being more favorable. On the other hand, the recognition of commercial payment terms under FMS contracts could be construed as an act contrary to the Congressional mandate to reduce FMS in favor of commercial sales.

Use of contract options for FMS

The present ASPR coverage which was revised in 1973 to permit the exercise of contract options for FMS requirements suffers from at least two shortcomings. First, it is not clear that specific advance notice is to be provided to the contractor in cases when an option may be exercised to fulfill FMS demands. Second, when the option price was originally established for the purpose of fulfilling U. S. requirements, the subsequent exercise of the option for the benefit of FMS would have the effect of disallowing the FMS cost and profit factors that would normally be recognized.

The ASPR FMS Subcommittee has made recommendations aimed

at correcting these deficiencies.[1] First, when it is anticipated that the DOD may exercise an option to fulfill FMS requirements, the option provision will be modified to provide advance notice to the contractor. Second, when the contract does not provide for the right to exercise an option for FMS requirements, the contractor's agreement must be obtained prior to such action, and the contract price may be adjusted to include FMS cost and special profit factors. Finally, the proposed ASPR revisions are not intended to apply to options exercised for the purpose of rebuilding U. S. stocks or inventories or for spare parts intended for foreign use.

As a practical matter, it may not be possible to set forth a firm option price for FMS requirements in a contract calling for the production of items to meet DOD needs. The FMS price would be expected to vary based on quantity, customer, specification changes, delivery requirements and so forth. An approach used by some program offices deserves consideration by the ASPR Committee. Base prices for various quantity breaks are included in the contract for unspecified FMS requirements. At the time a letter of offer is processed, a contract modification exercising the option is issued to order the FMS items and to finalize the price based on the specific circumstances of the sale. This approach enhances the responsiveness of the procurement process to FMS requirements, provides advance notice

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[1]U. S., Department of Defense, Chairman, ASPR FMS Subcommittee, Memorandum for the Chairman, ASPR Committee, Subject: "Case 74-47, Use of Options for FMS," April 3, 1975.

to the contractor of possible option quantities and allows recognition of FMS cost and profit factors in the final option price.

The Contract Administration Phase

As indicated in the preceding chapter, the ASPR does not specify what contract administration services are to be performed with respect to FMS contracts. The letter of offer indicates that FMS contracts are normally subject to the same contract administration and inspection procedures as DOD requirements; however, there is evidence that, while full contract administration services are usually provided in support of FMS contracts, reimbursement under existing regulations is based upon performance of quality assurance (inspection) functions only.

An Air Force study recommends that: (1) the ASPR be modified to indicate that full contract administration services will be performed on all FMS procurements, and (2) the administrative surcharge of two percent be validated and appropriately adjusted to assure adequate reimbursement for such services.[1] Similarly, a separate DOD study recently questioned whether the administrative surcharge applied to FMS procurements is "all-encompassing, sufficient, established by accepted cost accounting practices, and reviewed on a periodic basis as required."[2]

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[1] Security Assistance Impact Study, Panel D, Task P, p. 3.

[2] International Logistics Program Systems Review, p. V-3.

Accordingly, the study recommends that a working group be convened to establish surcharge percentages that insure adequate reimbursement.

Finally, the extent to which U. S. Government representatives act as agents of a foreign government with respect to performing certain functions needs further investigation. Specifically, the performance of the acceptance function under the letter of offer on behalf of the foreign customer requires clarification as to legality and elaboration in the ASPR and appropriate DOD directives. In general, the concept of legal agency as it relates to the foreign military sales environment is deserving of increased attention in light of the growing complexity of our relationship with many foreign governments.

Summary

This chapter examined alternative approaches to transacting FMS including: (1) the creation of a separate agency to administer the Federal Government role in FMS, (2) the modification of the defense procurement process to have FMS procurements more closely approximate commercial transactions, and (3) the continuation of the concept of minimizing the unique treatment of FMS while responding to the problems identified through recommended policy and procedural revisions. Evaluation of the alternatives against selected statutory criteria and consideration of the anticipated impact on the parties involved--the DOD, U. S. industry and foreign governments--resulted in the conclusion that the minor modification approach

is the preferred alternative. The research combined and synthesized recommendations for policy and procedural revisions within the phases of the defense procurement process which provided the framework for analysis throughout the investigation.

The following chapter summarizes and states the conclusions of the research and suggests topics for additional study.

CHAPTER VII

SUMMARY AND CONCLUSIONS

The purpose of this chapter is to summarize the research, to state the conclusions of the study and to suggest areas deserving further investigation.

Research Framework and Approach

The basic framework for the research was the conceptualization of the procurement process offered by the Commission on Government Procurement. According to the Commission's Report, the procurement process includes the following phases:

1. Planning (forms of competition, types of contracts, and cost estimates)
2. Solicitation of sources
3. Selection and award (formal advertising and negotiation)
4. Contract Administration

The procurement process takes place within an environment of statutes and regulations, and the determination of procurement needs and provision of funding are viewed as exogenous factors influencing the process.

The objectives of the research were to examine the manner in which the defense procurement process has been modified over a period of time by the provision of unique policies

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and procedures to accommodate FMS procurements, to explore the evolution of the FMS program and to ascertain the procurement problems associated therewith, and to assess the implications of the evolving FMS program with respect to defense procurement policies and procedures.

Certain limitations were imposed to facilitate the manageability of the research project and to delineate the bounds of extrapolation applicable to the research. The inquiry was limited to FMS of major aerospace weapon systems and equipment conducted on a "procurement for cash sale" basis. Such transactions account for over forty percent of all FMS cases, and the policies and procedures relating to such sales are generally applicable to other categories of equipment and weapon systems. Procedures relating to sales from inventory, supply support arrangements and contracts for services were not specifically addressed. In addition, while the existence of a mechanism to insure consistency of FMS with U. S. foreign policy interests was pertinent to the research, the support or criticism of individual foreign policy decisions or specific foreign military sales was not within the scope of the investigation.

Subsidiary Research Questions

The primary research question posed, How has the foreign military sales program evolved, and what has been the resulting impact on defense procurement policies and procedures as they relate to FMS?, suggested further queries.

Accordingly, the subsidiary research questions represented a structured attempt to describe the evolution of the FMS program and to assess the policy and procedural implications thereof. The responses to the subsidiary questions collectively contribute to an answer to the primary research question. Each subsidiary question is restated, and the findings and conclusions of the research are thus summarized.

1. What trends are evident in the various segments of the Security Assistance Program (grant aid, foreign military sales, and direct commercial sales) since their inception?

Several dimensions of the evolution of the Security Assistance Program were highlighted by the research: (a) the continuing shift from grant aid to FMS, (b) the magnitude and scope of individual FMS transactions, (c) the complexity of items sold through FMS, (d) the shift in leading FMS customers, (e) the growing use of FMS as a tool of U. S. foreign policy, and (f) the increasing Congressional scrutiny of arms transfers.

While grant aid outlays have been on a relative decline since the mid-1960s (with the exception of service-funded military assistance during the Vietnam war) and commercial sales have been fairly stable in recent years, FMS orders have been growing rapidly. FMS orders received during the past three fiscal years, 1972-1974, totaled over $15 billion and exceeded the cumulative value of FMS orders for all prior years combined, FY 1950-1971. DOD statistics concerning prime contract awards to fulfill FMS orders reflect the increased activity. In addition to the Defense Security Assistance Agency's projection of

a continuing high level of FMS, other sources familiar with the Middle East and the NATO nations have also predicted substantial future sales.[1]

The size and duration of individual sales have also increased. In some instances, sales approach or exceed $1 billion, and deliveries extend into the next decade. In many cases, the follow-on support implications are as significant as the instant sales in terms of the overall U. S. commitment.

The complexity of items demanded through FMS is shifting backward in the weapon system life cycle. Weapons in early production and even developmental stages are being requested for FMS. At least two of the military departments have prepared regulations governing the management of FMS cases requiring significant development or systems integration efforts.

An emerging group of customers, primarily nations of the Middle East, has largely been responsible for the recent increase in FMS. The huge surplus of oil capital accumulated in the past few years is being used to modernize the armed forces of nations such as Iran and Saudi Arabia. As a consequence, these countries have moved to positions one and five on the list of leading FMS customers for the period FY 1950-1974. Israel is number three on the list primarily as a result of U. S. resupply efforts following the Mid-East wars, a

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[1]Recently published figures reflect total FMS orders for FY 1975 in excess of $9.5 billion. See U. S., Department of Defense, Defense Security Assistance Agency, Security Assistance Program: Congressional Presentation Document, Fiscal Year 1976 and 197T, November 5, 1975, p. 110.

substantial portion of which has been converted to grant aid.

Within the past year, the use of arms sales as a foreign policy tool has been amply demonstrated. Arms deliveries to Turkey were suspended by Congress as a result of the Turkish Government's use of U. S.-supplied arms in Cyprus. A reassessment of Middle East policy by the Ford Administration delayed deliveries of arms to Israel and others. Aircraft purchased by Libya have not been released for shipment as a result of political differences.

During the same period, Congress has intensified efforts to strengthen its role in foreign policy decisions and arms sale approvals. The Foreign Assistance Act of 1974 required that any letter of offer exceeding $25 million be submitted to the Congress for review and possible veto prior to consummation. In addition, numerous bills have been introduced in the Ninety-fourth Congress which, if approved, would substantially increase Congressional oversight of FMS and commercial arms exports.

In summary, the changing nature of the FMS program is reflected in the defense procurement process--greater dollar volume of FMS, higher dollar-value individual contracts for complex systems, a different customer mix, increased foreign policy considerations, and intensified Congressional scrutiny of arms sales.

2. <u>What is the nature of the defense procurement process, what are the critical determinations to be made in effecting foreign military sales, and how do procurements for FMS differ</u>

from normal defense procurements?

In Chapter IV, the defense procurement process was characterized as being governed largely by statutes and agency regulations having the force and effect of law. The Armed Services Procurement Regulation (ASPR) sets forth basic policies and procedures regarding eligibility criteria for contract award, contract placement matters, contract administration functions, cost principles, and other related areas of concern. It was found that major weapon systems are acquired under generally the same regulations, procurement methods and types of contracts as other DOD requirements.

Critical determinations in effecting FMS were identified through a review of the steps leading to the establishment of the FMS agreements between the U. S. and foreign governments and between the U. S. Government and the domestic defense contractor. The government-to-government agreement is initiated through a request by a foreign government which may require approval of the Department of State prior to processing by the Department of Defense. A pricing and availability study is prepared by the military department responsible for procurement of the item being requested. The Letter of Offer and Acceptance, DD Form 1513, is the document used to consummate the agreement between the two governments. Subsequent to acceptance by the foreign customer, the FMS contract between the U. S. Government and the domestic contractor is established within the basic framework of the defense procurement process as modified by the policies and procedures unique to FMS procurements.

The standard that has governed FMS procurements for a number of years is reflected in condition A1 on the reverse of the Letter of Offer and Acceptance: The DOD agrees to procure the items for the foreign government under the most advantageous terms and conditions consistent with DOD regulations and procedures employing, to the extent possible, the same contract clauses, the same contract administration, and the same inspection procedures, except as otherwise requested by the purchaser and agreed to by the DOD.

The phases of the defense procurement process have been modified to varying degrees to accommodate FMS procurements. The major differences between normal DOD purchases and FMS procurements are summarized.

In the planning phase, the ASPR requires that an advance procurement plan be prepared for large negotiated procurements. Although FMS procurements are not exempt from this provision, it is rare that FMS requirements are made known in sufficient time and detail to permit formal advance planning.

In the solicitation of sources, the ASPR recognizes the right of the foreign government to designate a single source of supply for the requested item or service, in which case the procurement can be made from the specified source without the additional approval that would be required for a DOD sole-source contract.

The greatest differences between FMS and DOD procurements are evident in the selection and award phase of the procurement process. Provision has been made for recognizing the

costs of doing business with a foreign government (e.g., international selling costs, post-delivery service costs and costs of translating technical manuals); rules governing the allowability and reasonableness of agent's fees have been expanded; a special profit factor for FMS has been established; and policies relating to recovery of nonrecurring costs, exercise of contract options, and authorization for rent-free use of government property have been promulgated.

Although unique ASPR guidance concerning contract administration for FMS is not in evidence, several instances were identified wherein contract administration for foreign military sales differs from contract administration for normal DOD procurements.

Analysis of the differences between policies and procedures governing FMS and DOD procurements suggests that an attempt has been made to accommodate FMS contracts within the basic framework of the defense procurement process to the maximum extent possible. Unique provisions of the regulations dealing with FMS procurements have been reserved for areas considered by the DOD to be worthy of special coverage as a result of : (1) statutory requirements, (2) the terms and conditions specified in the Letter of Offer and Acceptance, and (3) problems associated with FMS procurements.

3. <u>What are the major problems associated with foreign military sales that affect defense procurement policies and procedures?</u>

Problem areas associated with FMS procurements were

identified and analyzed in Chapter V utilizing the framework of the defense procurement process--exogenous factors, planning, source solicitation, selection and award and contract administration.

Funding and needs determination were considered as exogenous factors. (Funding methods for FMS procurements are not standardized.) Some procurement activities cite foreign trust funds directly on contracts while others cite U. S. appropriated funds which are subsequently reimbursed by the foreign government. DOD is giving consideration to standardizing FMS funding. Whether or not a single funding method is adopted, the legal implications of each approach need to be ascertained. From a procurement standpoint, the funding technique used and its effect on certain statutory and regulatory provisions now applied to FMS contracts requires elaboration and clarification.

(The needs determination process of the foreign government creates certain problems for procurement policies and procedures. For example, some requests for purchase are received "out of cycle," while other letters of offer are never accepted by the requester.) Consolidation of requirements or use of flexible contracting techniques may not be feasible.

Problems associated with the pricing and availability study and the letter of offer were examined in the planning phase of the procurement process. (During the preparation of the pricing and availability study, the limited involvement of procurement and contractor personnel is a matter of concern as is the tight time constraint imposed for such studies. There is

also pressure to provide a price for the letter of offer which will not require upward revision following acceptance. The letter of offer sometimes fails to communicate essential elements of the agreement between the two governments. For example, a sole-source designation may not be indicated, supporting equipment or services required may be omitted, and procedural variations agreed to may be inadequately communicated to procurement personnel.

Under source solicitation, problems were identified in three areas--clarifying the definition of commercial availability relative to FMS, resolving issues related to government-furnished equipment (GFE), and effecting the implementation of offset purchase arrangements. Pertinent DOD directives have not yet addressed how the definition of commercial availability should be modified to better reflect the will of Congress to return the maximum amount of FMS to direct commercial channels. Since GFE cannot be sold by the government to private parties, the presence of such components in an end item may dictate use of the FMS channel. It was found that mixed-channel sales create problems in coordination, cost recovery and determining responsibility for GFE. Offset purchase arrangements are increasingly being requested in conjunction with FMS being made to industrialized countries, and procurement policies and procedures reflecting contractor and government responsibilities with regard to reciprocal purchases are needed.

In the selection and award phase, problems were identified under the following headings: (1) pricing to recover full

costs, (2) payment of agent's fees, (3) special profit consideration for FMS, (4) financing arrangements under FMS contracts, and (5) exercising options for FMS.

Pricing to recover full costs is an issue which extends beyond the procurement functional area since several cost categories such as accessorial and administrative charges are recouped through surcharges applied to the letter of offer. The conflicting policies dealing with recoupment of research, development and production costs and with rent-free use of government-owned production and research property for foreign sales require reconciliation. It would appear that the rent-free use policy operates contrary to the statutory cost-recovery criterion. The problem of inadequate recoupment of recurring administrative costs seems to stem from the incomplete identification, recording and reporting of appropriate charges.

Several aspects of the payment of agent's fees on FMS contracts are a matter of concern. Procurement personnel have difficulty in applying tests for reasonableness and allowability developed for domestic situations to agent's fees in widely differing foreign environments. Distinguishing between legitimate fees and questionable payments is difficult in both FMS and other international commerce transactions. In addition, exorbitant fees have resulted from small percentage rates being applied to large dollar-value sales.

The special profit factor of one to four percent has not been uniformly interpreted and applied. For example, the

existence of overlapping ASPR language regarding FMS marketing costs and profit may result in dual recognition in some cases. The ASPR criteria governing the special profit factor should be clarified to facilitate more uniform application.

Contract financing arrangements in FMS procurements have been criticized by industry. Contractors have complained that normal DOD progress payment provisions require proportionally greater investment than if commercial-type payments were authorized. Consequently, contractors desire more favorable payment terms.

The exercise of contract options for the fulfillment of FMS requirements is also questioned by industry. Although the ASPR permits the use of options for FMS, two areas of concern remain. First, the contractor must be specifically advised that contract options may be exercised for the benefit of FMS to permit him to price accordingly. In addition, if the original option price was established for U. S. requirements only and did not include any consideration of FMS cost and profit factors, it appears that a price adjustment would be authorized if the option is to be exercised to fulfill FMS demands.

Although unique ASPR coverage regarding contract administration for FMS is not in evidence, certain areas of concern were identified. Uniform procedures are needed for assigning contract administration functions and for insuring adequate reimbursement by the foreign government.

4. <u>What policy alternatives and procedural revisions within the defense procurement process are proposed as a result</u>

of the changing nature of the foreign military sales program?

In response to the problem areas identified, revisions to policies and procedures are proposed within each phase of the defense procurement process--exogenous factors, planning, source solicitation, selection and award, and contract administration. The proposals are aimed at: (1) clarifying procurement policies and procedures as they relate to FMS transactions, (2) aligning them more closely with expressed Congressional intent, and (3) eliminating inconsistencies in the application of such policies and procedures. The research seeks to synthesize recommendations drawn from many sources and to present them in an integrated manner within the framework of the defense procurement process. The recommendations are summarized as follows:

I. Exogenous factors

A. Funding of FMS procurements

(1) Determine the legal ramifications of direct citation and reimburseable approaches to funding FMS procurements and provide appropriate guidance to procurement personnel

(2) Standardize funding if further study indicates significant benefit to the DOD

B. Needs determination

(1) Require that Department of State and military advisors working with major FMS customers encourage advance planning of defense requirements

(2) Continue to seek authorization for inventory replenishment funds and to explore the use of flexible contracting

techniques to alleviate unfavorable impacts of FMS procurements on U. S. defense needs

II. Planning Phase

A. Pricing and availability study

(1) Establish time frames for preparation based on the scope and complexity of the proposed procurement

(2) Require early involvement of procurement and contractor personnel in preparing price and delivery estimates for submission to foreign governments

B. Letter of Offer and Acceptance

(1) Establish a procedure for a corporate review by functional representatives of major letters of offer

(2) Provide early notice of acceptance of the letter of offer to the procurement activity

III. Source Solicitation Phase

A. Commercial Availability

(1) Redefine present categories of commercially-available items and publish them in the Military Assistance and Sales Manual and the ASPR

(2) Assist foreign governments in developing procurement expertise and purchasing missions in the U. S. to encourage greater use of the commercial sales channel

B. Government-Furnished Equipment (GFE) Issues

(1) Monitor status of the current legislative proposal to permit the negotiated sale of GFE to private contractors and modify procurement policies and procedures accordingly

(2) Consider discontinuing mixed-channel sales of GFE

and end items

c. Offset Procurement Arrangements

(1) Adopt a contractual provision to delineate contractor responsibilities in fulfilling offsets associated with FMS

(2) Specify bid evaluation procedures when foreign sources are to be solicited under offset purchase arrangements

(3) Explore the feasibility of establishing basic agreements with foreign governments to address the contractual provisions that will be recognized in future contracts by both parties to the agreement

4. Selection and Award Phase

a. Cost Recovery

(1) Revise the policy regarding rent-free use of government property to better reflect the statutory cost recovery intent

(2) Clarify calculation and waiver procedures concerning recoupment of nonrecurring research, development and production costs

b. Agent's Fees

(1) Identify such fees early in the pricing and availability stage and disclose them fully to the foreign government

(2) Improve the tools available to the contracting officer to assist in the evaluation of reasonableness of agent's fees

c. Special Profit Consideration for FMS

(1) Adopt recommendations to differentiate between cost

and profit factors by clarifying definitions and criteria

(2) Clarify application of the special profit factor to exclude sales from inventory and follow-on sales of spare parts

d. Financing and Payment Terms –

(1) Recognize higher contractor investment for commercial-type items when the contractor is not responsible for the use of the FMS channel to consummate the sale

e. Options for FMS Requirements

(1) Require that specific advance notice be provided to the contractor if options may be exercised for the benefit of FMS needs

(2) Include appropriate FMS cost and profit factors in option prices

5. Contract Administration Phase

(1) Establish uniform procedures to assign contract administration functions for FMS procurements and to provide improved identification, recording and reporting of charges to be reimbursed for such services

(2) Examine practices relating to foreign government acceptance of supplies and services under FMS agreements

Alternative Approaches to FMS Procurements

The analysis of problems associated with FMS procurements called into question the present approach for procuring FMS requirements on behalf of foreign customers--the adaptation of the basic defense procurement process to the task with only minimal unique treatment, as specified in condition A1 of the

Letter of Offer and Acceptance. The increased volume and complexity of FMS in recent years, coupled with the problems identified, suggested reconsideration of the present approach. In evaluating alternative approaches, the anticipated impact on the parties involved as well as the criteria for the FMS program were taken into consideration. Alternative approaches were proposed on three different levels:

1. Establish a separate executive agency to administer Department of State and DOD roles in FMS, and remove FMS purchases from the defense procurement process. This alternative extends beyond the defense procurement process to embrace the entire U. S. Government involvement in foreign military sales.

2. Make major modifications to the defense procurement process to have FMS contracts approximate commercial transactions to the maximum extent. Elements of such a system would include: (a) revising DOD cost principles to recognize interest, advertising and other commercial expenses, (b) allowing commercial financing terms, (c) prohibiting exercise of contract options for FMS, (d) citing foreign trust funds directly, and (e) making certain socio-economic provisions nonapplicable to FMS.

3. Make minor modifications within the defense procurement process to continue the concept of contracting for FMS and DOD requirements on the same basis to the maximum extent possible.

The results of the evaluation of alternatives support a continuation of the policy of minimizing the unique treatment

of FMS procurements and the retention of such transactions within the framework of the defense procurement process.

The Primary Research Question

The objective of the investigation was to respond to the primary research question: How has the foreign military sales program evolved, and what has been the resulting impact on defense procurement policies and procedures as they relate to FMS?

The evolution of FMS has been demonstrated--greater volume, increased complexity and closer Congressional scrutiny of arms transfers. The DOD approach in the past has been to treat FMS contracts within the basic framework of the defense procurement process. The increasing burden on the DOD and the major problems associated with FMS procurements have been identified, as have recent DOD efforts to address the procurement policy and procedural implications of the evolving FMS program.

The impact of FMS on defense procurement policies and procedures has also been established. Revisions are needed within every phase of the procurement process--planning, source solicitation, selection and award, and contract administration. Certain statutory requirements are inadequately considered, several policy and procedural areas require clarification, and some emerging issues need to be addressed to keep pace with the changing FMS environment.

The Foreign Military Sales Act makes arms sales to friendly foreign governments an integral part of our national defense posture. A continuation of the present policy would

appear to result in the least disruption to the attainment of the primary objective of the defense procurement process--to fulfill DOD requirements for goods and services from the private sector. Therefore, in response to the problems identified, the emphasis in the policy and procedural improvements being sought should continue to minimize the unique treatment of FMS procurements.

The conclusion supporting a continuation of the present policy is based on the premise that FMS are made to facilitate the common defense, i.e., arms sales to foreign governments fulfill mutual defense needs that would otherwise require increased U.S. combat capability. To the extent that FMS are driven primarily by economic or foreign policy considerations, the continuation of the present policy becomes increasingly subject to question. In light of the growing Congressional scrutiny of and public interest in FMS, it appears that the Departments of State and Defense may wish to reexamine the statutory and regulatory framework surrounding such sales and to clarify the role of FMS.

Suggestions for Further Research

Among the areas deserving additional study are the following:

1. Further explore the alternative to create an executive agency to administer foreign military sales since this approach goes beyond the procurement functional area to include political, organizational and economic factors outside

the scope of the present research

2. Review legislation and related regulations affecting the FMS procurement environment to determine applicability to such contracts

3. Explore the integration of the major weapon system acquisition process with FMS procurement management requirements

4. Determine the impact of permitting negotiated sale of GFE to private contractors to facilitate direct commercial sales

5. Examine the adequacy of the administrative surcharge reimbursement and the accounting procedures for identifying, recording and reporting such costs

6. Investigate the economic aspects of offset procurement agreements

7. Clarify the concept of legal agency as it relates to FMS

The FMS environment is expanding and rapidly evolving to encompass political, legal and economic factors which were scarcely considered in the past. The Department of Defense has identified many implications of the growing commitments associated with FMS and has initiated several on-going efforts to bring about improvements in FMS procurement policies and procedures. A continuing involvement with the FMS program coupled with the identification of areas for additional research suggest that there are many management challenges yet to be addressed.

APPENDIXES

THE DEPUTY SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

MAR 2 8 1975

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
DIRECTOR OF DEFENSE RESEARCH & ENGINEERING
ASSISTANT SECRETARIES OF DEFENSE
GENERAL COUNSEL
DIRECTOR, TELECOMMUNICATIONS AND COMMAND AND CONTROL SYSTEMS
ASSISTANTS TO THE SECRETARY OF DEFENSE
DIRECTORS OF THE DEFENSE AGENCIES

SUBJECT: Foreign Military Sales

I am concerned that all elements of the Department of Defense may not be performing their FMS responsibilities in a sufficiently careful and responsive fashion. I urge each of you to reassess your own personal role and that of your institution in seeing that FMS matters are handled with the care and dispatch that they deserve. You should review current policy and your organization's capacity to implement it.

It is United States policy to approve foreign military sales (FMS) only when consistent with U.S. foreign policy. The Foreign Assistance Act and the Foreign Military Sales Act promulgate the general policy regarding FMS. The policy is synopsized as follows:

> While its goal is a world free of the burdens of armaments, the U.S. recognizes a continuing need for international defense cooperation to maintain peace and security. Thus, consistent with its foreign policy interests, and with due regard for impacts on social and economic development and on arms races, the U.S. will enter into arrangements with friendly countries for the sale of defense articles and services needed by such countries to equip and operate their forces. To the extent practicable, sales will be made through commercial channels.

APPENDIX A

The management of approved sales programs must be subject to the same high standards of efficiency applies to procurement, delivery, and resupply of our own forces. This includes a responsibility to insure the equipment or service provided meets real needs without non-essential additions; procurement at a fair price; and efficient supervision of contractor performance. It also includes participation with the customer country in planning for proper use and follow-on support of the equipment sold.

All addressees should review current management of their FMS responsibilities to insure sufficient qualified personnel are assigned in view of the rising FMS workload. Organization arrangements should also be examined with the view to increasing efficiency and raising the visibility of FMS to top management levels.

Nothing in the foregoing should be construed as revising current regulations for pricing of personnel services for FMS. The full cost of providing such services will continue to be fully recovered. This means that tooling or production rates of FMS contracts cannot be increased unless the purchaser pays the full cost. Guarantees of protection against price escalation, increased production costs, and similar cost increases should not be extended to the purchaser. The purchaser must continue to accept all risks of cost growth, but it is incumbent on Military Departments to make the purchaser aware of significant potential cost growth in FMS contracts.

Prompt logistical support from the DOD supply system need be provided only if the purchaser enters into Cooperative Logistics Support Arrangements, thus providing funds at the time of procurement to raise DOD spare parts stock levels so that DOD spares levels will not be impacted.

In sum, the FMS program is designed to make sales only if it serves our national interest and to meet valid military requirements. Once the FMS program is approved its success should be assured by proper applicable of DOD management expertise.

H. P. Clements Jr.

APPENDIX B

INTERVIEW GUIDE

1. What is the role of your organization with respect to procurements for foreign military sales (FMS)?
2. What is your position within the organization?
3. How are you involved in procurements for FMS?
4. What major FMS procurements have you been/are you now involved in?
5. Please identify and discuss current problem areas associated with FMS that affect defense procurement policies and procedures?
   (a) As they relate to phases of the procurement process:
      - funding and needs determination
      - planning
      - source solicitation
      - selection and award
      - contract administration
   (b) As they relate to existing procurement regulations:
      - obtaining pricing information from contractors
      - recognizing special costs in FMS contracts
      - payment of agent's fees
      - special profit consideration for FMS
      - recovery of nonrecurring costs
      - sole-source authorization for FMS
      - options for FMS
      - rent-free use of government-owned property

6. What suggestions would you make, if any, for policy or procedural revisions relating to:

- individual problem areas cited?
- the manner in which FMS procurements are handled within the defense procurement process?

APPENDIX C

INDIVIDUALS CONSULTED

Adams, James O. Chief, F-4 Procurement and Production Division, Aeronautical Systems Division, Air Force Systems Command (AFSC), Dayton, Ohio, June 17, 1975.

Anthony, Al A. Directorate of Military Assistance and Sales, DCS/Systems and Logistics, HQ USAF, Washington, D.C., May 19, 1975.

Bath, Sally H. Chief Statistician, Aerospace Industries of America, Inc., Washington, D.C., May 28, 1975.

Bennett, John J. Deputy Assistant Secretary of Defense, Installations and Logistics, Washington, D.C., May 13, 1975.

Booton, Robert E. Office of the Deputy Assistant Secretary of Defense (Procurement), Contract Placement and Finance Division, Washington, D.C., July 9, 1975.

Boykin, J. Arthur Jr. Technical Director, Weapon Systems, Aeronautical Systems Division, AFSC, Dayton, Ohio, June 16, 1975.

Braverman, Jerry. Policy Division, Deputy for Procurement and Production, Aeronautical Systems Division, AFSC, Dayton, Ohio, June 18, 1975.

Buckingham, Richard P. Contract Pricing Branch, Directorate of Requirements and Procurement, Army Materiel Command, Alexandria, Virginia, April 25, 1975.

Caffiaux, Jean A. Vice President, Electronic Industries Association, Washington, D.C. May 27, 1975.

Carlberg, Major Ronald L. Systems Procurement Division, Directorate of Procurement Policy, DCS/Systems and Logistics, HQ USAF, Washington, D.C., April 17, 1975.

Clark, Albert. Policy Division, Defense Security Assistance Project, Chief of Naval Material, Arlington, Virginia, July 21, 1975.

Conner, Colonel Henry H. Chairman, Contract Finance Committee, Office of the Deputy Assistant Secretary of Defense (Procurement), Washington, D.C., May 6, 1975.

Crehan, John T. Director of Accounting Policy, Office of the Deputy Assistant Secretary of Defense (Management Systems), Washington, D.C., May 7, 1975.

Cribbins, Joseph. Special Assistant for Aviation Logistics, DCS/Logistics, HQ U.S. Army, Washington, D.C., June 6, 1975.

Cuffe, Donald S. Director, Program Planning and International Logistics, Office of the Assistant Secretary of Defense, Installations and Logistics, Washington, D.C., May 19, 1975.

Dooley, Woodrow E. Contract Pricing Branch, Directorate of Requirements and Procurement, Army Materiel Command, Alexandria, Virginia, April 25, 1975.

Dulin, Colonel Billy J. Deputy Director, Military Assistance and Sales, DCS/Systems and Logistics, HQ USAF, Washington, D.C., May 19, 1975.

Eisenstein, B. ASPR Policy Member, Defense Supply Agency, Alexandria, Virginia, April 14, 1975.

Fabro, Colonel Frank. Assistant Deputy, Program Management Advisory Group, HQ Air Force Systems Command, Andrews AFB, D.C., November 6, 1975.

Garrett, Marshall J. Director, International Service, Aerospace Industries Association of America, Inc., Washington, D.C., May 28, 1975.

Garrett, Richard N. Specialized Aircraft Program Office, Aeronautical Systems Division, AFSC, Dayton, Ohio, June 17, 1975.

Goebel, Al. Chief, Procurement and Production Division, International Fighter System Program Office, ASD, AFSC, Dayton, Ohio, June 18, 1975.

Hansen, Colonel Robert H. Chief, Security Assistance Requirements Group, DCS/Research and Development, HQ USAF, Washington, D.C., May 7, 1975.

Haugh, LeRoy J. Director, Contract Placement and Finance, Office of the Deputy Assistant Secretary of Defense (Procurement), Washington, D.C., April 29, 1975.

Jennings, Joseph. Security Assistance Division, Naval Air Systems Command, Arlington, Virginia, July 22, 1975.

Keenan, Thomas. Deputy Director, Procurement and Production, Army Aviation Systems Command, St. Louis, Missouri, July 25, 1975.

Kinsinger, Paul C. Research Assistant, The Brookings Institution, Washington, D.C., May 29, 1975.

Kirchmer, Eugene W. Deputy Director, Procurement and Production, Aeronautical Systems Division, AFSC, Dayton, Ohio, June 16, 1975.

Klung, Lt Colonel Henry A. Acquisition Management Staff Officer, DCS/Research and Development, HQ USAF, Washington, D.C., May 7, 1975.

Kunsemiller, John H. Deputy for Acquisition Management, Directorate of Procurement Policy, DCS/Systems and Logistics, HQ USAF, Washington, D.C., April 17, 1975.

Lamping, Major Neal E. Program Officer, Security Assistance Requirements Group, DCS/Research and Development, HQ USAF, Washington, D.C., May 7, 1975.

Leist, James B. F-4 Contracts Group, Aeronautical Systems Division, AFSC, Dayton, Ohio, June 17, 1975.

Marshall, Lt Commander Clyde M. Chief, Acquisition Programs Branch, Procurement and Production, Naval Material Command, Arlington, Virginia, April 29, 1975.

Melburn, Michael. Systems Accountant, Directorate of Accounting Policy, Office of the Assistant Secretary of Defense (Comptroller), Washington, D.C., May 7, 1975.

Miller, Captain Mel R. Directorate of Programs and Budgets, DCS/Comptroller, HQ AFSC, Andrews AFB, D.C., May 22, 1975.

Moore, Ronald G. Contracting Officer, Light Helicopter Procurement Section, Procurement and Production, Army Aviation Systems Command, St. Louis, Missouri, July 24, 1975.

Mumma, Willard H. F-4 Contracts Group, Aeronautical Systems Division, AFSC, Dayton, Ohio, June 17, 1975.

Murray, Joseph A. Chief, Light Helicopter Procurement Section, Procurement and Production, Army Aviation Systems Command, St. Louis, Missouri, July 24, 1975.

Murtomaki, Duane. Systems and Analysis Office. Directorate of International Logistics, Army Materiel Command, Alexandria, Virginia, April 25, 1975.

Nelson, Erling W. Deputy Counsel, Naval Air Systems Command, Arlington, Virginia, July 22, 1975.

Norton, Leslie M. Professor of Logistics Management, School of Systems and Logistics, Air Force Institute of Technology, Dayton, Ohio, June 16, 1975.

Orsini, Captain John. Sales Negotiation Division, Defense Security Assistance Agency, Washington, D.C., April 17, 1975.

Perucci, Augustine. Special Assistant to the Project Manager, Defense Security Assistance Project, Chief of Naval Material, Arlington, Virginia, July 21, 1975.

Ramos, Jesse S. Policy and Planning Division, Procurement and Production, Naval Material Command, Arlington, Virginia, April 29, 1975.

Rigdon, James W. Contracting Officer, Light Helicopter Procurement Section, Procurement and Production, Army Aviation Systems Command, St. Louis, Missouri, July 25, 1975.

Ryan, Captain William J. Director of Procurement, Office of the Assistant Secretary of the Navy (Installations and Logistics), Arlington, Virginia, May 14, 1975.

Saylor, J. W. Investment Division, Directorate of Accounting Policy, Office of the Assistant Secretary of Defense (Comptroller), Washington, D.C., May 7, 1975.

Semminella, Bernard. Office of Munitions Control, Department of State, Washington, D.C., May 27, 1975.

Silber, Jerome. Office of the Assistant General Counsel, International Affairs, Department of Defense, Washington, D.C., May 23, 1975.

Smith, Lt Colonel Fred. Course Director, Defense International Logistics Management, Army Logistics Management Center, Fort Lee, Virginia, March 14, 1975.

Smith, Robert. Security Assistance and Sales Division, Bureau of Politico-Military Affairs, Department of State, Washington, D.C., June 2, 1975.

Straetz, Major Donald. International Division, DCS/Research, Development and Acquisition, HQ U. S. Army, Washington, D.C., June 6, 1975.

Strouse, George. Chief, Price/Cost and Financial Analysis Branch, Contract Administration Directorate, Defense Contract Administration Services, Alexandria, Virginia, April 8, 1975.

Sullivan, Captain Patrick D. SC, USN. Director, Weapon System Procurement, Office of the Deputy Assistant Secretary of Defense (Procurement), Washington, D.C., April 30, 1975.

Tambe, Colonel J. T. Director, Logistics Studies Office, Army Logistics Management Center, Fort Lee, Virginia, March 14, 1975.

Wrigley, A. J. Contracting Officer, Specialized Aircraft Program Office, Aeronautical Systems Division, AFSC, Dayton, Ohio, June 17, 1975.

Zaner, Lt Colonel Howard W. Directorate of Systems Procurement, DCS/Procurement and Manufacturing, HQ Air Force Systems Command, Andrews AFB, D.C., April 30, 1975.

APPENDIX D

GLOSSARY OF SYSTEM DESIGNATORS

Designator	Description
F-104	A single-seat, single-engine, jet fighter-bomber first delivered to the Air Force in the late 1950s; contractor Lockheed-California Company; no longer in active Air Force service; still active in many NATO countries
F-4	A two-seat, twin-engine, tactical jet fighter flown by the Air Force and the Navy; contractor McDonnell Aircraft Company; first delivered in the early 1960s
F-5	A low-cost, single-seat, single-engine, air-superiority jet fighter developed in the 1960s for provision to U. S. allies under the Military Assistance Program; contractor Northrop Corporation; first delivered to the Air Force in 1973
F-14	A two-seat, twin-engine, variable-wing, air-superiority jet fighter; contractor Grumman Aerospace Corporation; first delivered to the Navy and Marine Corps in 1974
F-15	A single-seat, fixed-wing, twin-engine, all-weather, air-superiority jet fighter; contractor McDonnell Aircraft Company, first delivered to the Air Force in 1974
F-16	A high-performance, multi-purpose, single-seat, single-engine jet fighter prototype; contractor General Dynamics Corporation; currently under development for the Air Force
AH1J	A twin-engine, missile-firing, attack helicopter with crew of two; contractor Bell Helicopter Company; currently being produced for the Marine Corps

Designator	Description
Harpoon	An air-to-surface, radar-guided, anti-ship missile designated AGM-84A; contractor McDonnell-Douglas Corporation; currently in initial production for the Navy
Hawk	A surface-to-air, semi-active radar-homing, anti-aircraft missile designated MIM-23B; contractor Raytheon Company; currently in production for the Army

Sources: Aviation Week & Space Technology and Air Force Magazine.

APPENDIX E

UNITED STATES DEPARTMENT OF DEFENSE

OFFER AND ACCEPTANCE

(1) PURCHASER (Name and Address)(Include ZIP Code)

(2) PURCHASER'S REFERENCE

(3) CASE DESIGNATOR

OFFER

The Government of the United States hereby offers to sell to the above purchaser the defense article(s) and defense service(s) listed below, subject to the terms contained herein and conditions cited on the reverse.

(4) THIS OFFER EXPIRES _____, 19___.

(5) SIGNATURE, TYPED NAME AND TITLE OF US REPRESENTATIVE

(6) DATE

(7) US DEPARTMENT OF _____

ITEM OR REF. NO. (8)	ITEM DESCRIPTION (Including stock number, if applicable) (9)	QUANTITY (10)	UNIT OF ISSUE (11)	ESTIMATED UNIT COST (12)	ESTIMATED TOTAL COST (13)	AVAILABILITY AND REMARKS (14)

(15) ESTIMATED COST	$
(16) ESTIMATED PACKING, CRATING, AND HANDLING COSTS	
(17) ESTIMATED ADMINISTRATIVE CHARGE	
(18) ESTIMATED CHARGES FOR SUPPLY SUPPORT ARRANGEMENTS	
(19) OTHER ESTIMATED COSTS (Specify)	
(20) ESTIMATED TOTAL COSTS	$

(21) TERMS

ACCEPTANCE

(22) I am a duly authorized representative of the Government of _____ and upon behalf of _____ said Government, accept this offer under the terms and conditions contained herein, this (23) _____ day of _____ 19 _____.

(24) OFFER/RELEASE CODE _____

(25) FREIGHT FORWARDER CODE: _____

(26) MARK FOR CODE: _____

(27) POINT OF DELIVERY: _____

(28) TYPED NAME AND TITLE

(29) SIGNATURE

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CONDITIONS

Pursuant to the US Foreign Military Sales Act, as amended, the Government of the United States *(hereinafter referred to as "USG")* hereby offers to sell to the Purchaser the defense articles and defense services listed *(hereinafter referred to collectively as "items" and individually as "defense articles" or "defense services")* subject to the conditions set forth below:

A. THE GOVERNMENT OF THE UNITED STATES:

1. Agrees to furnish such items from its Department of Defense *(hereinafter referred to as "DOD")* stocks and resources, or to procure them under the most advantageous terms and conditions available consistent with DOD regulations and procedures. When procuring for the Purchaser, the DOD shall, to the extent possible employ the same contract clauses, the same contract administration, and the same inspection procedures as would be used in procuring for itself, except as otherwise requested by the Purchaser and as agreed to by the DOD.

2. Advises that when the DOD procures for itself, its contracts include warranty clauses only on an exceptional basis. However, the USG shall, with respect to items being procured, and upon timely notice, attempt to obtain any particular or special contract provision and warranties desired by the Purchaser. The USG further agrees to exercise, upon the Purchaser's request, any rights *(including those arising under any warranties)* the USG may have under any contract connected with the procurement of any items. Any additional cost resulting from obtaining special contract provisions or warranties, or the exercise of rights under such provisions or warranties or any other rights that the USG may have under any contract connected with the procurement of items, shall be charged to the Purchaser.

3. Shall, unless the condition is otherwise specified herein *(e.g., "As Is")*, repair or replace free of charge defense articles which are damaged or found to be defective in respect of material or workmanship and which are supplied from DOD stocks, when it is established that these deficiencies existed prior to passage of title. Qualified representatives of the USG and of the Purchaser, upon notification pursuant to paragraph B4 below, shall agree on the liability of the USG hereunder and the corrective steps to be taken. With respect to items being procured for sale to the Purchaser, the USG agrees to obtain and exercise warranties on behalf of the Purchaser pursuant to A2 above to assure, to the extent provided by the warranty, replacement or correction of such items found to be defective. In addition, the USG warrants the title of all items sold to the Purchaser hereunder. The USG, however, makes no warranties other than those specifically set forth herein. In particular the USG disclaims any liability resulting from patent infringement occasioned by the use or manufacture by or for Purchaser outside the United States of items supplied hereunder.

4. Agrees to deliver and pass title to the items to the Purchaser at the initial point of shipment unless otherwise specified herein. With respect to defense articles procured for sale to the purchaser, this will normally be at the manufacturers' loading facilities, with respect to defense articles furnished from stocks, this will normally be at the U.S. depot. Articles will be packed, crated or otherwise prepared for shipment prior to the time title passes. If "Point of Delivery" designated on the reverse is specified otherwise than the initial point of shipment, the supplying Military Service will arrange movement of the items to the authorized delivery point as reimbursable service. Custody must not be construed to mean retention of title.

4. Shall accept title to the defense articles at the initial point of shipment *(see A4 above)* unless otherwise specified herein. Purchaser shall be responsible for in-transit accounting and settlement of claims against common carriers. Title to defense articles transported by parcel post shall pass to the Purchaser on date of parcel post shipment. Standard Form 364 shall be used in submitting claims to the USG for non-receipt, overage, shortage, damage, duplicate billing, item deficiency, improper identification or improper documentation and shall be submitted by Purchaser promptly. Claims of $25.00 or less will not be reported for overages, shortages, or damages. Claims received after one year from date of passage of title or billing, whichever is later, will be disallowed by the USG.

5. Shall reimburse the USG if the final cost to the USG exceeds the amounts estimated in this sales agreement.

6. May cancel this order with respect to any or all of the items listed in this sales agreement at any time prior to the delivery of defense articles or performance of services. It shall be responsible for all costs resulting from cancellation under this paragraph.

7. Shall, except as may otherwise be mutually agreed, use the items sold hereunder only:

a. For the purposes specified in the Mutual Defense Assistance Agreement, if any, between the USG and the Purchaser;

b. For the purposes specified in any bilateral or regional defense treaty to which the USG and the Purchaser are both parties, if subparagraph a of this paragraph is inapplicable; or

c. For internal security, self-defense, and/or civic action, if subparagraphs a and b of this paragraph are inapplicable.

8. Shall not transfer title to or possession of, the defense articles, components and associated support material furnished under this sales agreement to any person, or organization *(excluding transportation agencies)*, or other government, unless the written consent of the USG has first been obtained. It shall not disclose, dispose of, or permit use of any plans, specifications or information furnished in connection with this transaction, except to the extent authorized in writing by the USG. To the extent that any items, plans, specifications, or information furnished in connection with this transaction may be classified by the USG for security purposes, the Purchaser shall maintain a similar classification and employ all measures necessary to preserve such security, equivalent to those employed by the USG, throughout the period during which the USG may maintain such classification. The USG will notify the Purchaser if the classification is changed. The Purchaser will ensure, by all means available to it, respect for proprietary rights in any defense article and any plans, specifications, or information furnished, whether patented or not.

C. INDEMNIFICATION AND ASSUMPTION OF RISKS:

1. It is understood by the Purchaser that the USG in procuring and furnishing the items specified in this agreement does so on a nonprofit basis for the benefit of the Purchaser. The Purchaser therefore undertakes, subject to A3 above, to indemnify and hold the USG, its agents, officers, and employees harmless from any and all loss or liability *(whether in tort or in contract)* which might arise in connection with this agreement because of: (i) injury to or death of personnel of Purchaser or third parties; (ii) damage to or destruction of (A) property of the DOD furnished to suppliers specifically to implement this agreement, (B) property of Purchaser *(including the items ordered by Purchaser pursuant to this agreement, before or after passage of title to Purchaser)*, or (C) property of third parties; or (iii) patent infringement.

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5. Advises that: a. Unless otherwise specified, USG standard items will be furnished without regard to make or model.

b. The price of items to be procured shall be at their total cost to the USG. Unless otherwise specified, the cost estimates of items to be procured, availability determination, and delivery projections quoted are estimates based on current available data. The USG will use its best efforts to advise the Purchaser or its authorized representative:

(1) of any identifiable cost increase that might result in an increase in the "Estimated Total Costs" in excess of 10 percent, but its failure to so advise shall not affect the Purchaser's obligation under paragraph B5 below.

(2) of any delays which might significantly affect the estimated delivery dates.

c. The USG will, however, use its best efforts to deliver items or render services for the amount and at the times quoted.

6. Under unusual and compelling circumstances when the best interests of the United States require it, the USG reserves the right to cancel all or part of this order at any time prior to the delivery of defense articles or performance of services. The USG shall be responsible for all termination costs of its suppliers resulting from cancellations under this paragraph.

7. Shall refund to the Purchaser any payments received hereunder which prove to be in excess of the final total cost of delivery and performance of this order.

B. THE PURCHASER:

1a. In payment for the items shall forward with its acceptance of this offer a check payable in United States dollars to the Treasurer of the United States in the amount shown as the estimated total cost, unless different arrangements are specified under "Terms".

b. Agrees, if "Terms" specify payment by "dependable undertaking" to pay the USG such amounts at such times as may be specified by the USG in order to cover shipments from stock or services rendered or to meet payments required by contracts under which items are being procured, and any damages and costs that may accrue from cancellation of contracts resulting from Purchaser's action under paragraph B6 hereof. Requests for funds may be based upon requirements for advances and progress payments to suppliers or delivery forecasts, as the case may be. Requests for funds and billings, when funds are not already on deposit, are due in full on presentation. Documentation concerning advance and progress payments or proof of shipment in support of bills will be made available to the Purchaser by the DOD upon request. When appropriate, the Purchaser will request adjustment of any questionable billed items by subsequent submission of required discrepancy reports in accordance with paragraph B4 below.

c. Agrees, if "Terms" specify payment on evidence of constructive delivery, to make payment in full amount of any request for funds or billing within the month following the month of the request, or as otherwise required in accordance with the "Terms" herein.

d. Agrees, if "Terms" specify payment under a Credit Agreement between the Purchaser and DOD, to pay to the USG on a "dependable undertaking" basis, in accordance with B.1b. above, such costs as may be in excess of the amounts funded by the Credit Agreement.

2. Shall furnish shipping instructions for the items with its acceptance of this offer. Such instructions shall include (a) Offer/Release Code, (b) Freight Forwarder Code, and (c) the Mark for Code, as applicable.

3. Shall be responsible for obtaining the appropriate insurance coverage, and, except for items exported by the USG, appropriate export licenses.

2. Subject to any express, special contractual warranties obtained for the Purchaser in accordance with A2 above, the Purchaser agrees to relieve the contractors and subcontractors of the USG from liability for, and will assume the risk of, loss or damage to Purchaser's property *(including the items procured pursuant to this agreement, before or after passage of title to Purchaser)* to the same extent that USG would assume for its property if it were procuring for itself the item or items procured pursuant to this agreement.

D. ACCEPTANCE:

To accept this offer, the Purchaser will return the original and three copies properly signed, to the US Military Department making the offer not later than the expiration date of the offer set forth herein. When properly accepted and returned as specified herein, the provisions of this offer shall be binding upon both Governments. Unless written extension is obtained from an authorized representative of such US Military Department, this offer shall terminate at the end of such expiration date.

E. ENCLOSURES:

Enclosures attached hereto are, by this reference, incorporated herein and are made a part hereof as though set forth in full

EXPLANATORY NOTES

1. The item or reference numbers appearing in the "ITEM OR REF NO:" column may not correspond with references used in your original request. However, this number, together with the case designator shown should always be used as a reference in future correspondence.

2. Availability lead time quoted in the "AVAILABILITY AND REMARKS" column is the number of months required to deliver items after receipt of acceptance of this offer pursuant to Section D above and the conclusion of appropriate financial arrangements. The planned source of supply for each item is expressed in the following codes:

S	(*)	Service Stocks
P	(*)	Procurement
R	(*)	Rebuild/Repair/Modification
X	(*)	Stock and procurement, e.g., initial repair parts

*Availability is stated in months.

3. Condition of the defense articles shown in the "AVAILABILITY AND REMARKS" column is expressed in the following codes:

A - Items to be provided in existing condition without repair, restoration or rehabilitation which may be required. Condition indicated in item description.

M - Articles of mixed condition *(new, reworked and rehabilitated)* may be commingled when issued. Example: repair parts, ammunition, set assemblies, kits, tool sets and shop sets.

N - Serviceable defense articles.

O - Obsolete or non-standard item in an "AS IS" condition for which repair parts support may not be available from DOD.

S - Substitute. Suitable substitutions may be shipped for unavailable defense articles unless otherwise advised by the Purchaser.

U - Reworked or rehabilitated defense articles possessing original appearance insofar as practicable; including all Modification Work Orders and Engineering Change Orders as applied to such defense articles when issued but defense articles should not be considered as having had total replacement of worn parts and/or assemblies. Only parts and components not meeting US Armed Forces serviceability tolerances and standards will have been replaced; in all instances such defense articles will meet US Armed Forces standards of serviceability.

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THE EVOLUTION OF THE FOREIGN MILITARY SALES PROGRAM AND ITS IMP--ETC(U)
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